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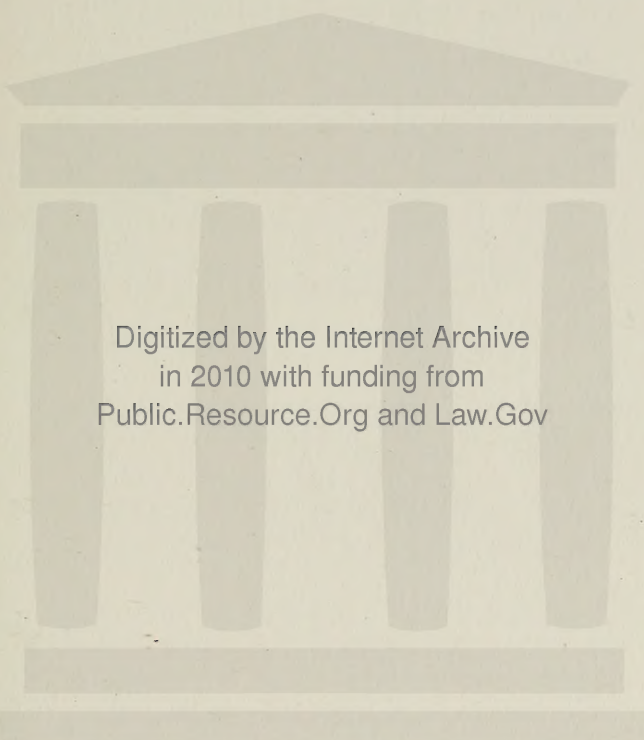
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See vol 2630
No. 12506

**United States
Court of Appeals**

for the Ninth Circuit.

See vol 2630
**WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I.
duP. BAYARD, Receiver,**

Appellants,

vs.

**WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,**

Appellees.

**MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE
& CO., INC.,**

Appellants,

vs.

**WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN
REALTY COMPANY, THE STANDARD REALTY AND DE-
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**Transcript of Record
In Five Volumes**

**Volume IV
(Pages 1363 to 1796)**

**Appeals from the United States District Court,
Northern District of California,
Southern Division.**

FILED
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PAUL GRADY

called on behalf of the defendants; sworn.

The Clerk: State your name to the Court, please.

The witness: My name is Paul Grady, G-r-a-d-y.

Direct Examination

By Mr. Adams:

Q. Where do you reside, Mr. Grady?

A. I reside in Greenwich, Connecticut.

Q. And you have your office in New York?

A. That is correct.

Q. What is your profession?

A. I am a certified public accountant.

Q. Are you now associated with Price, Waterhouse & Company? A. I am.

Q. In what capacity?

A. I am a partner of the firm.

Q. In how many States, Mr. Grady, do you hold a certificate as a certified public accountant?

A. Eleven States, including the State of California. [1233]

Q. Did you study accountancy in college?

A. I did.

Q. And where?

A. At the University of Illinois.

Q. When did you graduate?

A. I graduated in 1923.

Q. With what degree?

A. With a degree of Bachelor of Science.

Q. What was your first association as an accountant?

(Testimony of Paul Grady.)

A. Almost immediately after graduation from the University of Illinois I became a member of the staff of Arthur Anderson & Company in Chicago.

Q. How long did you remain with Arthur Anderson & Company?

A. Approximately nineteen years.

Q. And at that time, a part of that time, you were a partner in that firm?

A. I was a partner the last ten years of my association with the firm.

Q. While you were with Arthur Anderson & Company did you specialize in any particular field of accounting work?

A. I specialized in public utility accounting, although that was not exclusively my type of work.

Q. And were you in charge of the public utility work for Arthur Anderson & Company?

A. I was in charge of the public utility work in the New York [1234] office of Arthur Anderson & Company for a period of five years. Subsequently I was in charge of the public utility work for the entire firm for a period of approximately three years.

Q. When did you leave Arthur Anderson & Company? A. The early part of 1942.

Q. And what was your next association?

A. I left Arthur Anderson & Company to go with the United States Navy Department at the request of Secretary Forrester, for the purpose of assisting in the organization and determination of

(Testimony of Paul Grady.)

the policies of the cost inspection service of the Navy Department, that being the auditing organization of the Navy that was set up during the war-time period to audit procurement contracts.

Q. And would you describe briefly the work you did for the Navy.

A. Well, during that period my technical position was executive assistant in the Secretary's office, and I was assigned to the Cost Inspection Service in the Bureau of Supplies and Accounts. I assisted in setting up the policies in the preparation of the audit manual covering the procedures by which contracts were to be audited, and assisted in setting up the form of organization and in obtaining competent accounting personnel to fill the key spots in the organization. The organization had approximately 6000 employees after it was fully in operation.

Q. When, Mr. Grady, did you become associated with Price, [1235] Waterhouse & Company?

A. I became associated with Price, Waterhouse & Company in May of 1943, after the completion of my full-time assignment with the Navy Department.

Q. Now, would you describe, please, in general the fields in which you worked as an accountant.

A. During the period of something over a quarter of a century I have had experience in public utilities, railroads, manufacturing, general merchandise and financial type of business enterprises. I have also had considerable experience with Government corporation type of activities, as represented

(Testimony of Paul Grady.)

by the Reconstruction Finance Corporation, Federal Deposit Insurance, Rubber Reserve and Rubber Development, to name some of them. [1236]

Q. In respect of those governmental agencies, you have been engaged in work for the government of an accounting nature?

A. That is correct, accounting and auditing.

Q. Have you recently been connected with the commission on the organization of the executive branch of the United States Government?

A. I have.

Q. That is the commission sometimes known as the Hoover Commission? A. That is correct.

Q. What work have you done for that commission?

A. I was given the responsibility for making the survey of the lending agencies of the government for the purpose of preparing factual reports as well as a report on recommendations to the commission for the commission's consideration in arriving at their own recommendations to Congress.

Q. Have you recently made studies for the national military establishment?

A. I have been a member of a committee of five which has undertaken a rather comprehensive survey of the accounting—and by that I mean not only accounting in the sense of records but also in the broader sense of accounting control and budgetary procedures—of the national military establishment for the purpose of arriving at specific

(Testimony of Paul Grady.)

recommendations for the Secretary of Defense, and I might add that our report was likewise used [1237] by the task force covering the area of the Department of Defense for the Hoover Commission.

Q. Of what professional societies are you a member?

A. I am a member of the New York State Society of Certified Public Accountants; the Illinois Society of Certified Public Accountants; and the American Institute of Accountants. The latter is the national professional organization of certified public accountants.

Q. Have you been a member of some of the committees of the American Institute of Accountants?

A. Yes, I have been a member of quite a few of the committees.

Q. And you have been a chairman of some of those committees?

A. Yes, sir.

Q. Would you name some of the committees of which you have been chairman?

A. I was chairman of the American Institute committee on Public Utilities, in 1939 and 1940. I was also chairman of the committee on Auditing Procedure, which is one of the two principal technical committees of the Institute, during the four years that just ended last fall.

Q. You have done some writing on accounting questions?

A. Yes, I have written a fairly numerous amount of articles.

(Testimony of Paul Grady.)

Q. Could you give me a brief description of the nature of your publications?

A. Most of them deal with—— [1238]

The Court: Mr. Adams, is this witness going to testify to the same subject matter that the accountant testified for the plaintiff?

Mr. Adams: No, your Honor.

The Witness: Most of them deal with accounting, auditing and financial subjects, and they have been published for the most part in professional type of publications—I mean of the American Institute of Accounting or the American Accounting Association, which is the national organization of accounting instructors.

Q. Have you had any accounting experience with the railroad industry?

A. Yes, I have had accounting experience with the railroad industry.

Q. When did that begin?

A. Well, it began in the early 1920's, in the early days of my auditing experience. The principal amount of it during that period related to interurban electric railways, which at that time were quite commonly owned in affiliation with public utility groups. I have likewise had some experience in steam railroads. Would you like me to describe it or is that a part of the question?

Q. Would you please give a general description of your accounting experience in the railroad industry, adding anything you had in mind to supplement what you have already said.

(Testimony of Paul Grady.)

A. I have made the purchase investigations of the Alton Eastern [1239] Railway, the Litchfield and Madison, Illinois Terminal. I have supervised special studies of the accounts of the Illinois Central Railroad. I have recently been engaged in the rate case proceedings for the Canadian Pacific Railroad in Canada. I have likewise been consulted from time to time in connection with accounting and auditing matters for railroad clients handled by my firm, which includes the New York Central Railroad, Missouri Pacific, Frisco, Kansas City and Southern, Chicago, Rock Island and Pacific.

Q. Mr. Grady, in your accounting work have you had occasion to consider accounting problems of affiliated companies? A. Yes, sir.

Q. Would you say that your work in that connection has been a substantial part of your accounting experience?

A. Yes, it has been a substantial part.

Q. Could you give me roughly an estimate of what part of your work has been with the problems of affiliated companies?

A. I should judge that most of my accounting and auditing experience has been related to groups of more than one company, that is, a group containing more than one company in the corporate structure, to the extent of perhaps more than 50 per cent of my total time.

Q. When did your work involving affiliated groups begin?

(Testimony of Paul Grady.)

A. That began in the very early days of my experience.

Q. Has it continued up to the present time.

A. Yes, sir.

Q. In connection with your work on groups of affiliated corporations, have you had occasion to consider the tax problem of these groups?

A. From an auditing and accounting viewpoint, Mr. Adams, yes.

Q. In that connection have you had occasion to consider the allocation of taxes among group numbers under consolidated returns?

A. Yes, that is one of the problems with which I would deal.

Q. How does that matter come to your attention in your work?

A. In the examination of the tax accounts—by that I mean the tax accrual accounts, which are the liability accounts, and the tax provisions, which are expense accounts—it is necessary in the examination of any group of companies for the independent accountant to determine three things:

First, that the liabilities for federal income taxes for all years which may be open are reasonably provided for;

Second, that the tax provisions for the particular year for which income statements are being given are reasonable provisions in relation to the taxes owed to the government on account of the operations for those years;

(Testimony of Paul Grady.)

And thirdly, that the allocations within the group, between affiliated companies, are on some reasonable basis. The latter point is, of course, particularly important where the accountant is asked to give his opinion with respect to the financial [1241] statements of individual companies.

Q. Are you familiar, Mr. Grady, with the customary business practice for allocating taxes under consolidated returns?

Mr. Phleger: May it please the Court, I am going to object at this time as it is perfectly evident what the course of subsequent questions will be. I object to this whole line of testimony. I take it that what counsel is trying to do now is to prove, if there be such, some general practice of allocating the taxes between companies joining in a consolidated return, and I submit that the testimony is irrelevant, incompetent and immaterial. I have previously urged that the practice of those companies themselves is not admissible. How any general custom, if there be such, would be admissible is wholly beyond me. It is not even shown that the custom was known to the parties. We have a situation here which counsel on the other side has said is unique, and it seems to me that this testimony therefore is utterly irrelevant, incompetent and immaterial. If the witness proposes to testify as to what the law is, then it is also not admissible.

Mr. Adams: Are you finished?

Mr. Phleger: Yes.

(Testimony of Paul Grady.)

Mr. Adams: First, responding to the last statement that Mr. Phleger made, we do not have any purpose, your Honor, to ask the witness to testify with regard to the law, of course. The law is for your Honor to determine, and no testimony from this witness is adducible on the subject of what the law is. Our purpose in producing this witness to give testimony with regard to the business practice, is that only, and I think counsel has fairly stated that he anticipates that is our purpose, and it is our purpose. We propose to draw to your Honor's attention, as a material factor, a business factor as a fact that your Honor may consider. We expect to show that under the established business practice for the allocation of taxes, the taxes are allocated among the members of the group without making any payment such as the plaintiff demands here. And in my opening statement to the court, I said we expected to adduce proof of the practice of business as one of the elements in our defense. Of course we are not bound by plaintiff's theory—your Honor has referred to that. We expect to show that the only recognition given in business practice, at the most, is recognition to a particular company that joins in a consolidated return, which will put it in a position not less favorable than it would have been on a separate return basis. In this case the corporation would have been in no different position, the plaintiff, on a separate return basis.

(Testimony of Paul Grady.)

Now we have called Mr. Grady to produce testimony with regard to business practice and not with regard to any question of law. That is clearly so. Now your Honor, we think this evidence does bear directly on the fundamental issue, whether the plaintiff has a claim. The claim, it is admitted, is [1243] predicated upon a position it was of no consequence whatever to the plaintiff corporation, whether or not a separate or a consolidated return was filed.

And so in bringing to your Honor's attention a business practice, just as long ago business practices were brought before Lord Mansfield, we believe we are bringing to your Honor's attention a matter of significance and materiality that your Honor would wish to consider in determining the issues that this particular case presents for your Honor's determination. And it will be our position that in many a consolidated return situation, there are the possibility of claims such as are here presented, but the fact is otherwise. So that in any defense of the matter before your Honor, though this is defined by plaintiff in his definition as a special consideration, will require necessarily consideration of the effect such a decision might have upon an established business practice of not paying loss companies for tax advantage of their losses.

May I say further, in our own theory of the case, the ultimate question before your Honor is whether or not a loss company is entitled to be paid for the tax advantage its loss brings to the group. We do

(Testimony of Paul Grady.)

not agree with plaintiff's view that the plaintiff's own case presents such a special situation, that a special rule can be made for it, different from the rule generally obtaining in business practice.

Then, your Honor, we think this evidence is also material [1244] in refuting the interveners' position; counsel for the interveners, my friend, Mr. Levy, the other day made a somewhat elaborate and to me, quite clear, statement of his position. If I may take the privilege of paraphrasing it briefly, as I understand it, it was that in view of the relation between the members of the affiliated group, the tax transactions had to be conducted fairly, and there was a suggestion made that fairness required that payment be made to the loss company. Now we think the best evidence of fairness, or at least material evidence of fairness, may be found in the fact we seek to prove, that American business has never found occasion to make payment for the use of losses included in consolidated returns. We will argue that this equity court will not impose a rule contrary to the standards of the business community which, in our judgment, is in fact predicated upon the notion that the plaintiff corporation had a position to exact or coerce a payment, though its own joiner in the return was wholly immaterial to itself. [1245]

And then, if your Honor please, there is one other fact that this matter of business practice is material to: Both of our adversaries have gone to

(Testimony of Paul Grady.)

great pains to point out that the persons who handled the transactions had positions both with the plaintiff corporation and with the court's trustees. And it is contended that by reason of this, your Honor is entitled to review what was done at that time. Now, it is well established that in any case of a review of that sort, assuming that in this case this is an appropriate case for a review of that sort, the review cannot be made on the basis of hindsight. It must be based upon a perception of the conditions as of the time the transactions took place. And it will be our position that the officers and directors of the corporation at that time were fully justified in handling this transaction, if they followed what we seek to prove, namely, the established procedures customarily used in the business field.

I have stated at some length the reasons why we seek to introduce into the record of this case and to bring before your Honor not a question of law, but a question of fact, as of course the matter of business practice is. And those are my purposes in producing Mr. Grady and conducting this examination.

I might say further, just directing your Honor's attention to an allegation in the complaint in intervention, page 20 at the bottom, referring to the tax transactions here in [1246] issue, "Said transactions were in violation of recognized and good accounting practice." Now, that is another issue.

(Testimony of Paul Grady.)

It is not an issue directly responsive to the question of—well, I think it is. So far as it says that they are in violation of recognized and good accounting practice, I would submit, your Honor, that proof of what the practice of independent industry was with regard to this matter would be responsive to this allegation. That is an additional ground to those I have heretofore stated, on the basis of which we submit, your Honor, that the evidence sought to be adduced with regard to the business practice in this very matter is material and relevant to the issues in this case.

* * *

Mr. Adams: May I just add one minor remark? Counsel in stating an objection referred to the fact that the practice or custom that I seek to adduce at this time has not been shown to be known to the parties. I do not think that is material, but if it is material, we have evidence by which we can connect it up.

Mr. Levy: Your Honor, there is just a question or two to Mr. Adams, to clarify my own understanding of what the function of this witness is. Is the witness produced to [1247] testify as to business practice, accounting practice, or both?

Mr. Adams: The witness is produced to testify to the practice, custom and usage of business. I am not at all clear whether I shall ask him any questions about accounting practice, but he is of course experienced in that, and I would not have the slight-

(Testimony of Paul Grady.)

est objection to his being asked by any counsel on accounting practice, regardless of whether or not I opened that subject with him. [1248]

* * *

The Court: I am not discussing this matter with you on the theory that I think the plaintiff is entitled to recover in the case. I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns, because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, and of course there is no dispute about the fact that the parent company filed the affiliated returns whenever it decided it was [1253] proper to do so. What we have in this case is not concerned with that. It is a question whether under these circumstances, according to what I have heard so far, the parent company did decide to file this affiliated return in this case under the circumstances, whether it was the decision and action, in fact, under the particular circumstances that we have here of the parent company, No. 1; if it was not, then was there any liability or right that accrued to the parent company by virtue of what was done? I do not see that what this witness can say as to the practice of allocating taxes in this kind of return would have any particular bearing upon the matter. I think I could answer the question for him. And I do not see that it

(Testimony of Paul Grady.)

would add anything to it. I would think that probably you could not put your finger on a case in the United States where there was an affiliated return filed where anybody ever allocated any taxes between the companies. Why should they? There would not be any purpose to it.

Mr. Adams: Your Honor, I think from that standpoint the investigation we have made and the experience of Mr. Grady would aid your Honor because there is a standard practice of allocating taxes, and there was twenty years ago an investigation by the Federal Trade Commission that we ourselves as counsel expect to draw to your Honor's attention under which the Federal Trade Commission investigated the practices of holding companies with respect to intercompany transactions in Federal income tax [1254] and certain practices of the holding companies, literally the practice of lifting up computed taxes from subsidiaries, were found to be wrong, and the holding company act was passed, and now we have certain legal limitations and rules of the Securities and Exchange Commission with regard to that. But those are matters which are mentioned in response to your Honor's thought that the holding companies managed all of this as if it were their own. Of course, as long as there is no other interest—if there is a hundred per cent ownership, and no equity ownership in the subsidiary, the problem does not arise any way because it makes no difference what the parent com-

(Testimony of Paul Grady.)

pany does with its own. But the problem immediately arises where in the chain of corporations there are minority interests, as very frequently there are; then the question of right comes up and your Honor has before him in this case a question of right. It is not a question of what a parent company has power to do. I am sure your Honor is never going to grant a judgment on the basis that the parent corporation had the power to hold up the court.

The Court: I am inclined to agree with you on that, but what flowed from what was done in this case? What right flowed from what happened in this case, if any?

Mr. Adams: Your Honor is going to look to see if this plaintiff corporation has a right. We think it would assist your Honor's consideration of that matter to have before your [1255] Honor certain facts, and we do think—this is our own view of the matter and our own case that we are seeking to put in—that the general business practice is a material fact, for the reason that, as we see it, if there is a general business practice that is followed, then immediately the burden is upon the other side to show why under the particular circumstances a departure should be made from the general business practice. I have said this before, and I do not want to tax your Honor's patience too much, but we do regard this as a part of our case.

The Court: The question would never arise under the general business practice, because I do

(Testimony of Paul Grady.)

not think you would ever have any litigation. Absent the kind of situation that you have here between companies that were free agents to agree with one another to file this type of return. Here you have a situation where a third party, a new party, is getting the benefit of this tax situation. Now, maybe it is right it should. I am not attempting to decide that question. I can see that that is a difficult one upon which you gentlemen have given me much to think about. But the problem that is presented by it is entirely different from what might happen in the ordinary business relationship of parent and subsidiary companies, where you have not the interposition of reorganization proceedings and all that they entail. [1256]

* * *

The Court: I think there is not a fair comparison there [1263] with admiralty because it is pretty much of a different type of jurisdiction. But frankly, Mr. Adams, I cannot see that business practices are competent by way of evidence in the case unless it is necessary to make use of them in order to properly interpret a contract, something that the parties have agreed to that presents a problem which needs explanation because of uncertainty or ambiguity as to the meaning of what the parties have agreed to do. Resort can always be had, then, under the old-time rule of Lord Coke (somebody else cited some other lawyer, so I will cite one, too): "You show me what the parties

(Testimony of Paul Grady.)

have done under the contract, and I will tell you what they meant by their contract.”

You can, evidentially speaking, of course, produce this type of evidence in situations of that kind, but all that kind of evidence, it seems to me, would do in a case like this might be to lead the court into error, just as much to your disadvantage as it might be to your advantage if you win the case, because a reviewing court might well say the judge was influenced by what other people did at other times where the disputes were not judicially determined. They may say he should not have done that. He was listening to rumor; he was listening to what they did in the stock exchange, what the railroad companies did between one another as a matter of practice. That had an effect on his mind which it should not have had. He should have only listened to the relevant evidence in [1264] the case. I think you may call my attention by way of argument, with wide latitude, to any precedents of any kind, experiences, in an argumentative way, in support of the reason and justice of your side of the case, but I think that this type of evidence would produce error if the Court were to admit it. I think there was only one question before the Court at the time, but I think the colloquy has established fully the nature of the testimony that the witness is to give, and I think the proper holding would be to say that that is immaterial and incompetent and should be excluded.

(Testimony of Paul Grady.)

Mr. Adams: I would like in that connection, your Honor, at this time to make an offer of proof so that we can have a clear record of what it is that we are offering, and possibly your Honor may think, as I go through this, that the ruling that your Honor has made is not covered. I would also like, before I make my offer of proof, to direct the Court's attention to the fact that this objection came upon the following question:

"Are you familiar with the customary business practice for allocating taxes owing under consolidated returns?"

I think I am entitled to an answer to that question. The objection then would be to the question, "What is the practice?"

The Court: Of course, you agreed with Mr. Phleger as the argument proceeded, and I took it for granted we were not [1265] proceeding on too technical a basis. You agreed with Mr. Phleger as to the nature of the evidence that the witness was going to testify to.

Mr. Adams: There is no doubt about that. My point is this: In order to qualify my witness I think I should have an answer to this question. It does not produce any testimony as to what the practice is.

The Court: All right. You may answer it.

Q. (By Mr. Adams): Mr. Grady, are you familiar with the customary business practice for allocating taxes owing under consolidated returns?

(Testimony of Paul Grady.)

Mr. Phleger: This assumes that there is a custom. [1266]

The Court: Well, if there be such customs, are you familiar with them?

The Witness: Yes, sir.

The Court: All right.

Mr. Adams: Of course there is no doubt there is a customary business practice, and I am surprised that counsel makes such a suggestion. Then my next question is, after this one: What is that practice. And I understand counsel states an objection to that.

Mr. Phleger: Right:

Mr. Adams: And the Court ruled that the objection is sustained?

The Court: Right.

Mr. Adams: Now then, your Honor, I should like to ask Mr. Grady three or four more preliminary questions, which will develop the fact that in addition to speaking from his own experience, he has made a special study. And I think I am entitled to develop that fact. And then an objection may be made.

The Court: Well, is there any further objection, or any objection to the further qualification of the witness?

Mr. Phleger: No, but I would point out that if this is a general custom known to everyone, why does he have to make a special study?

Mr. Adams: I see no reason for these interpolated arguments.

(Testimony of Paul Grady.)

Mr. Phleger: Well, that was indirect response to the Court. [1267]

Mr. Adams: I am frequently advised by Mr. Phleger in advance of hearing the question what his point is about something he anticipates I am going to say.

The question is, your Honor, those are the questions: In connection with this litigation, were you asked to make an investigation to supplement your own information as to the general practice of allocating taxes under consolidated returns.

The Court: Well, Mr. Adams, do you feel that this long colloquy and argument we have had doesn't sufficiently describe the nature of the testimony of the witness?

Mr. Adams: No, your Honor, not at all.

The Court: And what you would have to show is such that you would have to make a further elaborate statement?

Mr. Adams: No, that is not my purpose at all; I have to put on my proof for the record, and this is simply a preliminary matter of proof, that a study was made. I am sure I am entitled to do that. And then there may be objections, your Honor. I have got to establish first that a study has been made. Now nothing objectionable results from that. But if I am not able to show that, I haven't shown what my witness would say, the entire basis of his qualifications to answer these questions, and of his investigation. I am not going to

(Testimony of Paul Grady.)

ask any questions as to what the practice was.

The Court: Well, there is a popular misconception amongst lawyers on this idea of making an offer of proof. It doesn't [1268] add anything to the record in the case. The only purpose of an offer of proof—or at least when I used to make them myself—was to get the judge to know about the thing that I wanted to get in anyhow, thinking that might make some difference. But if the question is objectionable and there is a good objection to it, there is no need for making an offer of proof. In any case, there is certainly no misunderstanding as to any of the lawyers here as to what we are talking about.

Mr. MacKinnon: Well, under the federal rules, there is a definite procedure to be followed now, and I think it is rule 43.

The Court: Well, what is that?

Mr. Adams: But your Honor, I am not even seeking to make an offer of proof, I want to ask some preliminary questions of the witness, just as I did before.

The Court: Very well.

Q. (By Mr. Adams): In connection with this litigation, were you asked to make an investigation to supplement your own information as to the general practice of allocating taxes and under consolidated returns? A. Yes.

Q. Was it left to you to determine in what field the investigation should be made? A. Yes.

(Testimony of Paul Grady.)

Q. What fields did you select? [1269]

A. I selected the public utility field, the steam railroad field and the general field of industrial practice.

Q. And why did you select these fields?

A. Because I thought they perhaps constituted the major segments of industry in which large scale or more than, multiple, corporate enterprises existed.

Q. And when did you begin this investigation?

A. In June of 1948.

Q. And when was the investigation completed?

A. Approximately February 1, 1949.

Q. Did you have some assistance in conducting it?

A. Yes, I had numerous assistants from my own organization.

Q. And was it conducted under your supervision and direction? A. Yes, sir.

Q. Will you describe the investigation you made in the public utility field, without stating anything about the results? A. We examined——

Mr. Phleger: Well, if your Honor please, it is perfectly obvious that this witness made a very extensive examination, and I don't think——

Mr. Adams: Well, why not hear about the results?

Mr. Phleger: Why hear about it?

The Court: Well, the witness has answered, and the record may show that he made an extensive and

(Testimony of Paul Grady.)

thorough examination of the organization, with the organization he had at his command, [1270] and the assistants and so forth concerning this matter you want to interrogate him about. So you needn't go into detail on that, I don't think. [1271]

* * *

The Court: If you think it is necessary after all this discussion, after all the discussion we have had during the last half hour, all that was elicited—if you think that nevertheless you have to particularize on the very matter we have agreed to, as the subject matter of the testimony, why, I cannot agree with you on it but if you want to make an offer of proof and take up that time in doing it, why I will allow you to do so.

Mr. Adams: Your Honor, I do feel that it is incumbent upon me in the pursuance of my responsibilities to make an offer of [1272] proof, and not for the purpose of rearguing any matter, but so that I may have my record. And it is for that purpose that I now make this offer of proof, to prove:

“That the witness, Paul Grady, reviewed or directed the review of reports filed with the Securities and Exchange Commission for the years 1942 to 1947, inclusive, of the 52 registered public utility holding company systems which are listed in the June 30, 1947, report of the Public Utilities Division of the Securities and Exchange Commission; that 52 holding company systems included 824 individual companies, the total consolidated assets of

(Testimony of Paul Grady.)

which amounted to approximately \$15,350,000,000; that the review was carried out to determine, wherever possible, whether consolidated or separate Federal income tax returns were filed and, in the case of the companies filing consolidated returns, to ascertain any information shown regarding the income tax reductions resulting from consolidated returns and the method of allocation among affiliated companies of such reductions; that in the case of 20 of the systems it could not be determined what types of income tax returns were filed; that 3 of the systems filed separate returns; that 29 filed consolidated returns.” [1273]

* * *

Mr. Adams: If your Honor please, with the consent of all counsel, the offer of proof which I started to read may be copied into the transcript without the necessity of reading it before your Honor.

The Court: Very well.

“That there were only five exceptions to Rule U-45 by the 29 systems which filed consolidated returns during the six year period; that two of these exceptions were granted to Consolidated Electric and Gas Company (a Subholding company of Central Public Utility Corporation), and one each to Cities Service Company, Ogden Corporation and United Public Utilities Corporation; that in four of these cases, the exceptions from the rule were requested and granted in order that particular subsidiary companies would not be in a less favorable

(Testimony of Paul Grady.)

position than they would have been had they not been a party to a consolidated income tax return; that in the case of one of the exceptions granted to Consolidated [1274] Electric and Gas Company, the holding company was permitted to distribute the consolidated tax in such a manner as to collect from the subsidiary companies the amount of tax reductions attributable to specific investment losses incurred by the parent in the disposition of securities of former subsidiaries; that the Securities and Exchange Commission justified this exception, in part, on the grounds that 100% of the common stocks of the subsidiaries was owned by the parent company and therefore the parent would be in no different position than if the amounts had been paid as extra dividends; that the exceptions are fully described in Securities and Exchange Commission releases Nos. 4444, 4806, 5535, 5904 and 6375; that the review identified income tax reductions resulting from the filing of consolidated returns by registered public utility holding companies in an amount not less than \$72,000,000.00; and that many of these deductions totaling many millions of dollars were attributable to unusual and extraordinary types of tax deductions.

Class I Railroads

Defendants offer to prove:

That the witness, Paul Grady, reviewed or directed the review of stockholders' reports and the

(Testimony of Paul Grady.)

annual reports filed with the Interstate Commerce Commission for the [1275] years 1942 to 1947, inclusive, of all Class I railroads having more than four thousand miles of track for the purpose of ascertaining any information shown relating to the practices followed in allocating consolidated Federal income tax among members of an affiliated group; that inasmuch as these reports did not show any information on the subject, the witness interviewed or directed the interview of officials of 22 Class I railroads for the purpose of ascertaining the practice followed in the allocation of income taxes among affiliated companies during the periods for which consolidated income tax returns were filed; that the total revenues in 1946 of the aforesaid 22 railroads were two-thirds of the total revenues of all Class I steam railroads for that year; that in the cases of 20 of the 22 railroad systems, tax reductions from consolidated returns were allocated pro rata to companies having taxable net income; that two of the systems allocated such tax reductions to the parent company up to the point of offsetting the parent company's tax and any further tax reductions were allocated pro rata to subsidiary companies having taxable net income; that none of the 22 Class I railroad companies followed a practice of making payments to companies having taxable net losses, except in recognition of "carry-back" or "carry-forward" circumstances and [1276] then only to the extent necessary to put the particular

(Testimony of Paul Grady.)

company in a position not less favorable than it would have occupied on a separate return basis.

General Industrial and Commercial Companies

Defendants offer to prove:

That the witness, Paul Grady, in order to ascertain, where possible, the practice of allocating taxes followed by industrial companies, made or directed a review of the Forms 10-K and stockholders' reports filed with the New York Stock Exchange during the years 1942 to 1947, inclusive, by the companies included in the Dow-Jones list of industrials; that the reports of these thirty companies did not disclose any information relating to consolidated income tax allocation; that Price, Waterhouse & Co. audits one-third of the companies included in the list; that none of these companies follows the practice of making payments to companies having taxable net losses, except in recognition of "carry-back" or "carry-forward" provisions in order that the companies would not be in a less favorable position as a result of participation in consolidated returns; that the witness requested the Price, Waterhouse offices in the United States to report to him cases in which any of their client companies filing consolidated tax returns had allocated income tax reductions on bases other than [1277] pro rata (in relation to net taxable income or to separately computed taxes) to companies having taxable net income; that four cases were reported to him in

(Testimony of Paul Grady.)

which taxable net incomes amounts equal to taxes computed on an individual return basis; that in effect the parent companies thus retained the entire tax reductions arising from consolidated returns; that in three of the four cases 100% of the securities, both debt and stock, of the subsidiaries were owned by the parent; that in all of these cases, the amounts collected from subsidiaries did not exceed the consolidated income taxes and no payments were made to companies having taxable net losses except in recognition of "carry-back" and "carry-forward" circumstances.

General

And finally that the studies and inquiries made of public utility holding company systems, general industrial companies and Class I railroads demonstrate the practice followed by business enterprises in the allocation among affiliated companies of the income tax reductions arising from the filing of consolidated returns; that the customary practice in all three fields is to allocate the consolidated tax reductions pro rata among the companies having taxable net incomes; that such pro rata allocations have been accomplished by two principal methods: first, in relation to the taxable net incomes of those companies having such net incomes and, second, in relation to the computed taxes of each company if paid on a separate return basis; that in carrying out the second method it is sometimes necessary to make

(Testimony of Paul Grady.)

payments to companies in recognition of the effect of "carry-back" and "carry-forward" provisions of the income tax laws and regulations; that the reviews and inquiries disclosed a few exceptions to the foregoing general practice of pro rata allocation of income tax reductions arising from consolidated returns; that such exceptions may be grouped into two general categories; first, because of exceptional circumstances payments have been made to certain companies in order that they will not be adversely affected due to participation in consolidated income tax returns and, second, parent companies have in a few cases taken more than their pro rata share of the consolidated tax reductions; that in most of the latter type of cases the parent companies owned all of the senior securities of the subsidiaries as well as 100% of the voting stock; that the reviews and inquiries did not disclose any case in which payments had been made to a member of an affiliated group merely because such member had produced a taxable loss, thereby reducing the consolidated income tax which otherwise would have been payable." [1279]

Mr. Adams: No further questions of Mr. Grady. He is here for cross-examination if counsel desire to examine him.

The Court: Is there anything in this offer of proof that goes beyond the general compass of the subject matter that we have discussed, that you feel you should have before the Court, or is it the detail

(Testimony of Paul Grady.)

of the investigation and statement of the witness concerning the practices he finds to have existed as a result of his investigation?

Mr. Adams: I think that is a fair characterization of it, your Honor; it is wholly related to the matter of business practice, the studies made, and the practice as found, and the details.

Mr. Phleger: Now I don't know whether, the offering having been demed to be made, it is necessary for me to interpose an objection. If it is, I do, upon the grounds previously stated, and upon the further ground that an investigation of the offer indicates that it is not expert testimony about a custom, but the result of an inquiry and investigation summarized.

Mr. Clark: We join in that objection, your Honor.

The Court: Well, we may consider then that the offer of proof was made as a part of the proceedings upon the objection as made by your opponent, Mr. Adams, and that the ruling made is that the offer of proof, the proof offered, is held to be inadmissible as being incompetent, irrelevant and immaterial.

Mr. Adams: Yes, your Honor. [1280]

The Court: So your record will thus be clear.

Mr. Adams: Yes, your Honor, and I think counsel's later statement is correct. But so that I may have my record, I also offer at this time to prove upon the basis of the testimony of the wit-

(Testimony of Paul Grady.)

ness as to his own qualifications, that the witness is prepared to state what the practice is. And in that connection, he is prepared to state with regard to the practice, that with very minor exceptions within his personal knowledge, the practice was the practice of allocating taxes and that only among members of the group, and of not paying anything to a loss company for the tax advantage this loss brings to the consolidated group. I offer that in addition to the offer made on the basis of the studies.

Mr. Phleger: Well, this is an additional offer now?

Mr. Adams: That is right, upon the basis——

Mr. Phleger: Well, I make the same objection.

The Court: Same ruling in that regard. [1281]

* * *

Mr. Phleger: We have no cross-examination.

The Court: In other words, it would not be necessary for this witness to return for the purpose of being cross-examined on the subject matter of the offer of proof.

Mr. Phleger: No.

Mr. Clark: I think not, your Honor.

The Court: Very well.

(Witness excused.) [1282]

* * *

Mr. Adams: May I call Mr. Polk?

JAMES K. POLK

called as a witness on behalf of the defendant,
sworn.

The Clerk: Will you state your name to the
Court, please? A. James K. Polk.

Direct Examination

By Mr. Adams:

Q. Mr. Polk, will you please state your business
and business address?

A. I am an attorney at law, member of the firm
of Whitman, Ransom, Coulson and Goetz, with
offices at 40 Wall Street, New York.

Q. What legal training have you had, Mr. Polk?

A. I am a graduate of the Georgetown Law
School, 1925, LL.B., and in '26, LL.M., and had
about ten years' experience in the office of the
Chief Counsel, Bureau of Internal Revenue. Do
you want that experience in detail?

Q. Well, I think if you could give it, generally
describe it, I would like to have that.

A. Well, I served in the review division, the
interpretative division, and the appeals division in
the Washington office of the Chief Counsel. In
about 1932, I went to New York as the Chief Coun-
sel's representative in that area, and was repre-
sentative there until 1935, when I resigned and went
with Whitman, Ransom, Coulson and Goetz on

(Testimony of James K. Polk.)

their staff. In 1938 I was admitted to partnership, and have been a partner in charge of the federal [1284] tax matters that Whitman, Ransom, Coulson and Goetz handle.

Q. Now, have you had some accounting training?

A. Yes, I am a graduate of Pace and Pace, and I have kept myself as current as possible in accounting matters. A great deal of tax work that I have done over my period of work with the government—and with Whitman, Ransom, Coulson and Goetz—has been intimately associated with accounting matters.

Q. You spoke of Pace and Pace. What is that?

A. That is an accounting school.

Q. In Washington, D. C.?

A. Yes, I think their name is now changed to Benjamin Franklin Institute or something of that sort.

Q. In what courts have you been admitted to practice?

A. Admitted to practice in the courts of the District of Columbia and the State of New York, the United States Courts, District and Circuit Courts of Appeal, in New York, and the District Court of Columbia, the Supreme Court of the United States, the Court of Claims, the United States Tax Court.

Q. Have you specialized in any field of law?

A. Oh, I have specialized in federal tax law from 1920.

(Testimony of James K. Polk.)

Q. And could you describe briefly your experience in that field? You have already spoken of your time in the Bureau. Subsequent to that time?

A. Well, after leaving the Bureau, and with Whitman, Ransom, Coulson and Goetz, I have been in charge of federal tax matters [1285] of their clients. Approximately 50 per cent of my time has been continuously devoted to public utility tax problems. That involves not only the review of tax problems as they arise, but the giving of advice in connection with the preparation and filing of returns, and with the handling of contests, of asserted deficiencies or claims for refund.

Q. Now do you seek to keep yourself conversant with developments in the tax field as they come along? A. I do.

Q. And what do you do with that object in view?

A. Well, I read all the releases of Commerce Clearing House in the federal tax field and of other tax publications, and I keep posted on legislative matters as the various revenue acts go through. That is since the original act went through Congress in 1921, and all the acts up to the present act. I have followed them through their legislative history. I have also been a member of the committee on taxes, and then the successor section of taxation of the American Bar Association from its organization, and I have been chairman of the committees in that section of taxation or counsel member to the present time. [1286]

(Testimony of James K. Polk.)

Q. You recall, of course, that there came a time when the firm of Whitman, Ransom, Coulson & Goetz was employed by the reorganization trustees in the Western Pacific Railroad reorganization?

A. Yes, sir.

Q. When and by whom were you advised that the firm had been employed?

A. About April 1, 1943. I was advised by my partner, Colonel Coulson, that we had been retained to advise in the preparation of the Federal tax return for 1942 and generally in tax matters.

Q. What work did you understand you were to be called upon to perform.

A. The usual work of tax counsel, that is, to supervise and advise in connection with the preparation of the return and filing thereof, and the giving of advice on tax matters as they were brought to me or I found them.

Q. In speaking of the usual employment and purpose of employment of tax counsel, what did you perceive to be that purpose in this case?

A. Well, it is my understanding of the function of tax counsel to advise in respect of the facts in any situation, the statutes, and the Bureau regulations and such matters to see that the lowest tax is paid to the Federal Government. I assumed that that was my function in connection with the Western Pacific situation. [1287]

Q. At that time had you known of the pendency of the Western Pacific reorganization?

(Testimony of James K. Polk.)

A. Yes.

Q. Did you learn of the decision of the United States Supreme Court in that reorganization?

A. Yes, I knew about it, within a day or so after it was issued.

Q. The date of record shown here being March 15, 1943. Did you know at that time what interests, if any, your firm represented in the reorganization?

A. They represented the Arthur Curtis James interests.

Q. When you undertook this work as tax attorney for the reorganization trustees, what did you then do.

A. Well, I knew nothing of the facts and background, and so my first step was to acquaint myself with what had happened, as fully as I could, in prior years. I phoned the corporation office, talked with Mr. Curry, asked him for the prior year files, and went back to the date of reorganization. He told me to get in touch with Mr. Nicodemus, who would send them over to his office. I did get in touch with Mr. Nicodemus and went to his office within the next couple of days and briefly discussed the fact that I was going to look into those papers with him and talk over some other matters that were entirely unrelated to the Western Pacific situation, and took the papers to my office and started a survey of the tax history of the group.

Q. And that was the source you just described from which you [1288] obtained the material to work with?

A. Yes.

(Testimony of James K. Polk.)

Q. What if anything did you learn from your study of the background material with respect to the Federal tax history of the plaintiff corporation?

A. Well, I learned that from the time of the organization of the plaintiff corporation, from 1918 through 1941, consolidated returns had been filed, and from approximately 1930 to 1941 in the consolidated returns had been shown losses and no tax liability; that the operating company had had income in 1940 and 1941, but that the parent company continued to have losses and had had losses over the span of years certainly from 1930 to date. That is my recollection. I made desk notes of my review of the tax handling, the way the Bureau had closed the cases, as I went along; they were subsequently typed and went into the file.

Q. Did you make any arrangement in the spring of 1943 with respect to the employment of any person in connection with this tax work?

A. Yes, I did.

Q. What did you do in that regard?

A. I had found out that the returns for several prior years had been prepared by a Miss Valouch under the direction of Mr. Curry in the corporation office in New York.

Mr. Phleger: Just a moment. I ask that that be stricken [1289] out on the ground it is hearsay.

Mr. Clark: It is the conclusion of the witness, your Honor, under the direction of Mr. Curry.

(Testimony of James K. Polk.)

The Court: It does call for hearsay. I will sustain the objection.

Q. (By Mr. Adams): Go ahead, Mr. Polk.

A. I was told by Mr. Curry that the returns had been prepared in his office by Miss Valouch, and I was not satisfied that a return reporting approximately \$10,000,000 of taxable income should be prepared with only the single work of one person acquainted with taxes. So I suggested to Colonel Coulson that outside independent tax accountants' services should be secured. He agreed with me, and upon my recommendation I discussed with Mr. Frank Reilly the possibility of his doing this type of work. It was agreeable to him, and, accordingly, we arranged a conference in Colonel Coulson's office, at which were present Mr. Reilly, Mr. Nicodemus, Colonel Coulson and myself, and arrangements were made to have Mr. Reilly work with Miss Valouch in the preparation of the returns.

Q. What prior associations, if any, had you had with Mr. Reilly in tax work?

A. I had known Mr. Reilly since about 1937. He was tax accountant in the employ of the Consolidated Edison Company, and from 1940 on I had placed in his hands the preparation of the excess profits tax returns of the Consolidated Edison system and had [1290] worked with him in a review of the Bureau regulations and statutes, and I was entirely satisfied as to his qualifications as a tax accountant.

(Testimony of James K. Polk.)

Q. Mr. Polk, did you make any arrangements with respect to the manner in which the work would be handled? A. Yes.

Q. What were they?

A. The arrangements were that the return would be prepared at the corporation office at 37 Wall Street. The office there had just been in receipt of a large amount of unrelated papers, that is, they were not combined for tax purposes, from the West Coast, reflecting the balance sheet and the operations of the various companies on the West Coast, and they had to be reviewed, intercompany eliminations taken care of, and otherwise put into form for inclusion in the Federal tax return. I arranged that this work would be done by Miss Valouch and Mr. Reilly, who reported to me as they went along each tax problem as they encountered it, and the return was prepared over a period of six weeks, during which time they consulted with me and I advised in connection with the various income, deduction, and invested capital items.

Q. Did you prepare the 1942 Federal tax returns? A. Oh, no.

Q. Who did prepare them?

A. They were prepared, as I have described, by Mr. Reilly [1291] and Miss Valouch and whatever other help they had in the office over there. I do not know who typed the returns or the schedules.

Q. Did you do any of the accounting work in the preparation of the returns?

(Testimony of James K. Polk.)

A. None at all.

Q. What advice, if any, did you give with respect to the types of returns that should be filed?

A. In the course of the work, in connection with the preparation of the return, Mr. Reilly made the customary calculations on both consolidated and separate bases to determine which produced the least tax liability. These computations showed, as I recall it, that there was net tax advantage in the consolidated return reporting of approximately \$1,-500,000, and accordingly the returns were prepared that way.

Q. In that connection did you give advice as to the selection of the type of return to be filed under the circumstances?

A. I do not recall giving any specific advice. It was quite apparent which way produced the least tax liability.

The Court: You were not going to tell them to file one that cost a million and a half, obviously?

A. Certainly not.

Q. (By Mr. Adams): The record here shows, Mr. Polk, that the final returns for the year 1942 were filed May 15, 1943. Did you render any reports with respect to such returns? [1292]

A. Yes.

Q. Will you please state what you did.

A. It was arranged, I think, as to time by Mr. Curry or his office that a conference would be had in Mr. Nicodemus' office, and such a conference was

(Testimony of James K. Polk.)

had on May 18, 1943, and I took to that conference the desk notes which Mr. Reilly had prepared in the course of his work in the construction of the return schedules, and so forth, and there was a general discussion and explanation of the manner in which each item had been handled, I particularly remember that three major items were covered. They involved the consolidated return, the advantage over the separate return, which was apparent on the calculations, the change-over, which was recommended from retirement to depreciation basis in respect of the road accounts, and the possibility of a deduction for tax purposes arising out of the stock loss. There was also a recommendation that further work be done to back up the figures used in the returns since we had taken at face value figures that had been sent on from the West Coast, but without any analysis to see if they were proper or not.

Q. Did either Mr. Nicodemus or Mr. Curry inform you during the course of that conference on May 18 that they did not understand what you were discussing with them? A. Oh, no.

Q. There is in the record here a letter dated May 20, 1943, [1293] addressed by you to Mr. Curry, plaintiff's Exhibit 50. I ask that that be handed to the witness.

Now, Mr. Polk, referring to Plaintiff's Exhibit 50, did you write that letter at your own initiation?

A. Well, in the course of, or toward the conclu-

(Testimony of James K. Polk.)

sion of our conference in Mr. Nicodemus' office, it was suggested that the matters discussed be reduced to writing, and this letter was then prepared in response to that request for a written summary of the observations.

Q. What is the next thing you did in connection with the Federal tax work for the reorganization trustees?

A. The next thing was not until about the 1st of June, when I received a telegram and a phone call from Mr. Schumacher, who was in San Francisco. He stated that he had been going over with the company officials the letter of May 20, and that he wanted me to undertake the work recommended in that letter.

Q. Did you go directly to San Francisco?

A. No, I did not. I went first to Washington and I spent two days there with Mr. Reilly reviewing with the Bureau of Internal Revenue valuation division officials the Bureau requirements under Treasury MM-58 for the depreciation matter, and then entrained for San Francisco, and on the way I received a telegram from Mr. Schumacher asking me to meet him in Denver.

Q. Did you meet Mr. Schumacher there?

A. I did. [1294]

Q. Who was present at the conference with Mr. Schumacher in Denver?

A. Mr. Schumacher, of course; Miss Valouch, who had been out on the West Coast and was re-

(Testimony of James K. Polk.)

turning East with him; Mr. Reilly, Mrs. Polk and myself.

Q. The conference was held in the office car, was it not, of Mr. Schumacher?

A. They called it a business car.

Q. A business car? A. Yes.

Q. What was the subject matter of that conference?

A. Mr. Schumacher discussed the matters that were in that letter of May 20. He had a copy with him. And then he told me that it had been agreed that we should go ahead with the work recommended to be done in the letter in connection particularly with depreciation and that Mr. Elsey would provide me with whatever help was necessary. We discussed, as I recall it, a number of the physical properties of the road because we were to engage upon asset mortality study in order to complete this depreciation change-over.

Q. Did you next proceed to San Francisco?

A. I did.

Q. When did you first meet Mr. Charles Elsey?

A. The day I arrived there.

Q. And that was about when? [1295]

A. The 12th or 15th of June.

Q. 1943? A. That is right.

Q. What was the nature of your activities in San Francisco on that trip?

A. Well, there were two principal objectives on that trip. They were to assemble back-up material,

(Testimony of James K. Polk.)

particularly in support of the invested capital computations in the 1942 tax returns, and, second, to assemble enough information to know what election to make under Treasury MM-58.

Q. That had to do with change-over from retirement to depreciation accounting?

A. That is right.

Q. What discussions, if any, did you have in San Francisco in June, 1943, with respect to the subject matter of your letter of May 20, 1943, Plaintiff's Exhibit 50?

A. That was the letter which Mr. Elsey had when I met him for the first time in his office and the subject matter was generally discussed. There was some review of the stock loss situation, but that had not matured, and the principal discussion concerned the depreciation and the invested capital and other items.

Q. Did you also have discussions with other officers of the Western Pacific Railroad Company aside from Mr. Elsey at that time? [1296]

A. I did.

Q. With whom, please?

A. I had discussions with Mr. DeGraff, general auditor, Mr. Russell, his assistant, with Mr. Englebright, who was Mr. Elsey's assistant, Mr. Droit, the secretary of the company, Mr. Phillips, the chief engineer, Mr. Wyche, a statistical assistant to Mr. Englebright, Mr. Gloster, who is Mr. Phillips' assistant, and there may have been others, Mr. Gosney for one.

(Testimony of James K. Polk.)

Q. You were working on tax matters as counsel for a period of some days in the Western Pacific offices on that occasion? A. Yes, I was.

Q. Did you during the course of that visit also meet the trustees' counsel, Mr. Matthew, and discuss the tax matters with him? A. I did.

Q. At the time of such conferences what conclusion, if any, had you reached with respect of the advice ultimately given in connection with the taking of the stock loss?

A. I had not reached any conclusion different from that expressed in the letter of May 20. It was my judgment that the stock loss had not matured at that time for tax purposes.

Q. When was it that you decided to recommend the use of the stock loss in the Federal tax returns?

A. It was in the latter part of December, 1943.

Q. What, if anything, had meanwhile occurred on the basis of which you reached a decision to recommend use of the stock loss in the returns?

A. Well, the steps had been taken between the time of the entry of the order of approval of the plan that were required before the order of confirmation could be entered. The votes of security holders had been taken, and the entry of the order of confirmation and the expiration of the statutory period for appeal therefrom, and no appeal having been filed, it was in my judgment the determining factor, the identifiable event fixing the 1943 loss.

Mr. Adams: This record shows, I think counsel

(Testimony of James K. Polk.)

will agree, that the order of confirmation of the plan was made and entered October 11, 1943.

Q. Now when you arrived at your decision to recommend the use of the stock loss in the federal tax returns, did you discuss that matter at or about that time with anyone?

A. Well, I discussed it in New York with Col. Coulson before leaving for San Francisco. I left——

Q. Now before you pass to the leaving, then would you tell us so far as you can recollect it, what was the discussion you had with Col. Coulson in New York on that occasion?

A. Well, I reviewed with Col. Coulson the general principles of worthless stock, told him I thought that this stock had become worthless by act of the operation of law, and that it could be claimed as a deduction under the provisions of Section 23(g) 4 of the Internal Revenue Code. The colonel didn't think the deduction had too much prospect of allowance, but in any event, I told him I was going to recommend that it be claimed in the return for the year 1943.

Q. And this was shortly before you made another trip to San Francisco?

A. Yes, I left very early in January, the 4th or something like that, for San Francisco.

Mr. Adams: I shall not finish with the witness today, your Honor, but I can go further. Whatever your Honor's convenience [1299] may indicate is most desirable.

(Testimony of James K. Polk.)

The Court: I think you might go ahead a little further.

Mr. Adams: Very well.

Q. Now then, do you recall the date or approximate date when you arrived in San Francisco, in January, 1944?

A. I am afraid I can't. I know it was in the early part of January, but I have been here about fifteen times, and I have trouble keeping the dates straight.

Q. There is a paper in the record in this case, and various other things that we lawyers know who are in this lawsuit, indicating the date to be January 8, 1944. A. Yes.

Q. Now you did, while you were in San Francisco, prepare an opinion advising with regard to the use of the stock loss in the consolidated return?

A. I did.

Q. Who suggested that you render a written opinion?

A. I discussed the matter with Mr. Elsey and told him of my recommendation, and it was at his request that it was reduced to writing.

Mr. Adams: And I will ask that Plaintiff's Exhibit 54 be shown to the witness. (Document handed to the witness by the clerk.)

Q. Mr. Polk, referring to Plaintiff's 54, is this the finally delivered opinion that was written in response to Mr. Elsey's [1300] request?

A. Yes.

(Testimony of James K. Polk.)

Q. And now there has been some point made in the case of the fact that the signature of Whitman, Ransom, Coulson and Goetz to this opinion is the signature in the handwriting of Col. Coulson. Do you recognize it to be such?

A. No, I know it is not my handwriting.

Q. Well, we have agreed that it is Col. Coulson's signature—or the lawyers have. Now in connection with that matter, do you have any recollection with regard to how it came about that the opinion finally delivered emanated from the New York office of your office—strike that; it is not accurate.—emanated from your office which was in New York.

A. Yes.

Q. Well, please state your recollection in that regard.

A. Well, when it was requested that the opinion be prepared in writing and delivered at any early date to Mr. Elsey, I started to draft an opinion letter. I found that I did not have sufficient information in San Francisco. For one thing, I was under the impression that the stock of the operating company had been transferred on December 31. Mr. Droit told me that it had not been, or he would know about it; he was secretary of the company. Another thing, I wasn't entirely sure how much of the losses of the operating company had been availed of in prior consolidated return years; the sum of such losses would reduce the basis of [1301] the stock in the hands of the parent company, and

(Testimony of James K. Polk.)

reduce the loss that is allowable upon the worthlessness of its stock. So I prepared a draft of letter and sent it airmail to New York for check of the facts by my office there. I am sure that I discussed the matter over the telephone with Mr. Noneman, and Col. Coulson.

Q. Who was Mr. Noneman?

A. Mr. Noneman is a partner who specializes in federal tax matters, along with me, under my direction.

Q. Thank you. That is all of that letter.

Now while you were in San Francisco in January, 1944, did you have any discussions with respect to the adjustment of the book tax accruals for the year 1943? A. I did.

Q. And with whom did you have such discussions, and what was said?

A. The discussions were at several different conferences, but I talked the matter over with Mr. Elsey, Mr. DeGraff, Mr. Russell, Mr. Englebright; Mr. DeGraff was the general auditor, and the accounts, of course, were kept under his direction.

Q. And what is your best recollection as to what was said in those discussions on that subject matter of the adjustment of the book accruals for taxes?

A. Well, the adjustment for the book accruals was not particularly involved. All that had to be done there was to wipe out [1302] the amount accrued at the date the entry was passed, and credit operating revenues, since they had been charged in setting up the liability.

(Testimony of James K. Polk.)

Q. Is that what you would call a "reversal"?

A. That reversed the piecemeal entries that had been made over the eleven months. I do not believe the December entry had been posted.

Q. Now was any decision made at that time, when you were in San Francisco in January, 1944, with respect of the reversal of the tax accruals for '43?

A. Yes, it was decided that the proper thing to do would be to reverse the tax accruals for 1943.

Q. And who made that decision?

A. That decision was made by Mr. Elsey and Mr. DeGraff.

Q. Now do you know who prepared the 1943 tax returns? I am referring, of course, to the tax returns of the plaintiff corporation, being consolidated returns embracing the subsidiaries.

A. They were prepared in substantially the same manner in which the 1942 returns had been prepared. The draft material was forwarded from the West Coast to the New York office at 37 Wall Street, and there Miss Valouch, Mr. Reilly, Mr. Curry and whatever staff he had (of typists, and so forth) prepared the return. I was consulted as the work went along on the questions that arose.

Q. And would you say that your last statement was in answer to [1303] the question, "What work you did in connection with the preparation of those returns"?

A. I think so, with one addition; I know that

(Testimony of James K. Polk.)

it was at my advice that an additional extension of time was obtained, so that the depreciation election could be completed with the Commissioner of Internal Revenue before the actual filing of the return.

Q. Now during the preparation of the 1943 returns, do you recall any discussions you had either with Mr. Curry, Miss Valouch, or Mr. Reilly on that subject?

A. I cannot recall individual discussions. I know that there were discussions over the span that each return was being prepared.

Q. Now did you see and approve the 1943 federal tax returns before they were filed?

A. Well, I know I saw the returns, but I don't think that I approved them. I was consulted and the returns were prepared, and the tax accountants prepared the returns. I did not assume responsibility for the figures in them, or to approve them.

Q. Now when did you learn that the stock of the debtor company had been transferred by the plaintiff corporation to the reorganization committee?

A. Shortly after it happened, April 30, 1944.

Q. How did you learn of that fact?

A. In discussion with my partners.

Q. Now what effect, if any, did the transfer of that stock have [1304] on the federal tax work that you were doing for the trustees?

A. Well, it terminated the affiliated relationship

(Testimony of James K. Polk.)

which had theretofore existed between the parent corporation and the operating company and its affiliates.

Q. And did you discuss that subject with Col. Coulson?

A. Oh, yes, I discussed that over a considerable period before the transfer of the stock.

Q. And please state the discussion you had with Col. Coulson with regard to the effect on your federal tax work of that transfer of stock to the reorganization committee.

A. Well, I pointed out that the minute the stock was transferred and the affiliation was terminated, the availability of the stock loss carry-over into 1944 was also terminated; and the longer the affiliation could be kept in existence, the more use could be had of the stock loss carry-over.

Q. And what statement, if any, did Col. Coulson make to you in response to the views you expressed to him on that subject?

A. He said the termination of the bankruptcy proceedings was of paramount interest, and it could not be held open to take advantage of the tax loss.

Q. Now, Mr. Polk, when did you decide to recommend the type of federal tax return that should be filed for the year 1944?

A. Well, I knew the type of tax return that would be filed for 1944, insofar as the parent corporation and its affiliates, inclusion up to April 30, as soon as I knew the date of April 30. [1305]

(Testimony of James K. Polk.)

I mean, it is quite obvious that there would be no tax liability on such a return. As to the type of return which would be filed for the company and its affiliates for the remaining eight months of 1944, I could not determine that until after the income items for the entire year had been assembled, and alternative calculations could be made on separate and consolidated return bases, to see which produced the least tax liability.

Q. Now, Mr. Polk, do you know who prepared the 1944 tax returns, both the tentative returns that were filed March 15, 1945, and the final returns that were filed June 15, 1945?

A. I don't recall who prepared the tentative returns that were filed, but the final returns were prepared by Miss Valouch and Mr. Reilly, Mr. Curry was there, and I think in my own office.

Q. The record shows he came to your office on or about, early in June, 1945.

A. I mean the return, I think, was prepared in my own office.

Q. Now what work, if any, did you do in connection with the preparation of those returns for the year 1944?

A. My work was the same as for the previous or preceding years. As the various questions arose in the course of the preparation of the returns, I was consulted and advice was given. [1306]

* * *

Q. (By Mr. Adams): The record shows, Mr. Polk, in this case, that a claim for refund on ac-

(Testimony of James K. Polk.)

count of the taxes paid for 1942 was filed by the Western Pacific Railroad Corporation on or about March 9, 1945. What, if anything, did you have to do with the filing of the refund claim?

A. I had the refund claim drafted by one of the men in our staff, in our office, and gave it to Miss Valouch who, I believe, took it into Mr. Curry's office and had him sign it and file it with the Collector of Internal Revenue where the taxes were paid.

Q. Now bearing in mind the date, March 9, 1945, and the fact which is of record here that the New York office of the Western Pacific Railroad Corporation and Company was not closed until the end of that year, would that affect in any way your recollection as to the location at which these papers were submitted and filed, or this paper, rather?

A. No, I do not know where the physical signing of the claim for refund was done. I know that it was filed at the Collector's office in New York.

Q. Now do you recall when the Commissioner of Internal Revenue conducted the field examination of the federal tax returns for '42, '43, and the first four months of '44?

A. Those field examinations took place over a period of time in the spring of 1944 until about June of 1946. They were not carried on as a continuous activity, and the first—you just asked when. Do you want me to go ahead?

(Testimony of James K. Polk.)

Q. Yes, I think if you will give a general description it would help us along.

A. The internal revenue agent Leahy, of the agent's office in New York, came into my office, I think, the spring of 1944, and said that he had the 1942 return for audit and the '40 and '41 as well. I told him that a loss was going to be claimed in the 1943 which would have a carry-back effect into 1942, and he probably should audit '43 at the same time that he audited '42 and prior years. He agreed to that, but asked questions concerning the nature of certain deductions that appeared on the face of the returns for '42 and prior years and asked for analyses of reserves and matters of that sort. These were secured over a period of time and furnished him. They were secured from Mr. DeGraff in San Francisco. The audit did not become active until the latter part of 1945, and he concluded his examination and discussed with me his findings, proposed recommendations, sometime around June of '46.

Q. Well now, when, if you recall, did the matter of the stock [1308] loss first become a subject of discussion between you and the agent?

A. Well, as I just stated, I told him that the loss was going to be claimed in the 1943 return. He was aware of the nature of the claim from the beginning, but I did not discuss the loss with him until, oh, approximately six months before he completed his audit. In the meanwhile I had been en-

(Testimony of James K. Polk.)

gaged in assembling evidence and material, legal research, in support of the claim of deduction.

Q. Now I show you two documents, one marked Interveners' 90 for identification and entitled "Date of worthlessness of the Western Pacific Railroad Company's capital stock" prepared by Benjamin Graham, 52 Wall Street, New York 5, New York, April 18, 1946, which is a document beginning with a transmittal from Mr. Graham to your firm of April 25, 1946; and a report of Mr. Graham, 48 pages in length, with appendices. And I also show you the document identified as Interveners' Exhibit 90 for identification which is a report on "Worthlessness of Western Pacific Railroad Company capital stock in 1943," submitted to James K. Polk, Esq., Whitman, Ransom, Coulson and Goetz, 40 Wall Street, New York, dated April 12, 1946; which is also an extended document of 84 pages, and exhibits. (Handing to witness.)

I will ask you to state, please, Mr. Polk, what, if any, connection these exhibits I have just handed to you had to do with your presentation of the matter before the Commissioner of Internal [1309] Revenue's agent in New York.

Mr. Clark: We object to it on the ground it is incompetent, irrelevant and immaterial, your Honor; the tax matter is settled, the matter of the stock loss so far as this action is concerned, is fixed. Nothing further remains to discuss about it.

Mr. Adams: It is offered, your Honor, as a part of the work record of this witness, that is to say,

(Testimony of James K. Polk.)

his account of what he did. There has been an assertion here that the defendant took over the stock loss. We account for the participation of each witness who participated in this transaction. We have given the account of Mr. Ehrman and Mr. Elsey. Now I am presenting the account of the lawyer. It has to do with that. These reports themselves have to do with studies on the date of loss, as to which there is a controversy, since plaintiff's counsel keeps insisting that the date of loss was the date of the Supreme Court decision. We do not offer these reports as proving anything to the contrary, but as reports presented to the Commissioner of Internal Revenue in which the whole subject was exhaustively examined. It has to do with that.

Mr. Phleger: Your Honor, we have no objection to the statement of fact that the reports were made, but these are lengthy documents and we do not think the record should be extended. We have not expended the money to have them printed or photostated. [1310]

Mr. Adams: They were admitted on discovery and merely marked for identification after being examined.

Mr. MacKinnon: At this stage of the game I do not think they were offered in evidence. An objection was made to interrogating the witness as to what connection these reports had.

Mr. Phleger: Counsel said he intended to offer them.

(Testimony of James K. Polk.)

Mr. MacKinnon: The objection is clearly improper.

Mr. Phleger: We have no objection.

Mr. Clark: We object on the ground they are incompetent, irrelevant and immaterial.

The Court: If I understand the question correctly, and knowing lawyers and tax experts, he might talk for hours in answer to that question as to what connection these reports had with his work. All you are trying to show is he investigated the matter, secured other help, got other reports, as a tax man would do, and made his representations and arguments to the tax board. Is that about it? I mean to the Commissioner's office?

Mr. Adams: That is a fair statement, yes, your Honor. I am accounting for the work Mr. Polk did. This is a part of it.

The Court: Is anybody attacking his work?

Mr. Phleger: It was very satisfactory.

The Court: I do not see any necessity for this examination.

Mr. Clark: That is our point, your Honor.

The Court: I will assume, unless counsel indicates to the contrary, that the witness devoted himself effectively and [1311] efficiently and over a long period of time with the aid of assistants to presenting this tax matter to the Commissioner's office. Unless counsel indicate to the contrary, I will assume that that is so.

(Testimony of James K. Polk.)

Mr. Adams: There seems to be no demur, your Honor.

The Court: No.

Mr. Adams: Without asking the witness to give any detail of the work, I will ask him to sketch in the times during which that work was done, very briefly.

The Court: All right.

Q. (By Mr. Adams): Do you recall the approximate time when the field examiner concluded his work in connection with his examination of the returns for 1942, 1943 and the first four months of 1944?

A. Along toward the end of May, 1946.

Q. Were you informed of his proposed recommendation?

A. Yes, he informed me of his proposed recommendation.

Q. What was his proposed recommendation?

A. His proposed recommendation was that the loss be allowed as a 1940 loss, is the year in which the District Court had entered its order of approval in the bankruptcy proceeding.

Q. And I take it that had the loss finally been allowed for the year 1940, it would not have served any substantial advantage as a deduction in respect of the later war years?

A. There is some doubt about whether it could have had any effect [1312] in the year, 1942. It would have had no effect in any subsequent year,

(Testimony of James K. Polk.)

and the government would not have recognized any effect in 1942, the question there being, if you want me to sketch it, whether the net loss carry-over should be computed under the law applicable to the year to which the loss is carried or from which the loss originated.

Q. As I understand, the effect of your answer as to the year 1943 and following, if it had been finally determined that the loss took place in 1940, then it would not have operated in any wise as a deduction for 1943 and subsequent years?

A. That is correct.

Q. Following your learning of the proposed recommendation of the field examiner, what was your next step?

A. My next step was to take the matter up with the Office of Internal Revenue Agent in charge to whom the report would be addressed, and my first step in that direction was to get the required powers of attorney on file.

Q. What relation does having powers of attorney have to do with your checking the matter up with the Internal Revenue agent in charge?

A. Well, an investigating internal revenue agent can discuss a matter with anybody, whether he has a power of attorney or not, because he is merely examining for facts; but the conference requirements of the Bureau are that when conferences are to be held, powers of attorney must be filed by an authorized [1313] representative.

(Testimony of James K. Polk.)

Q. And did the internal revenue agent in charge afford you a hearing?

A. He did. I had an informal rather than a scheduled conference under Bureau procedure with Mr. Krigbaum, Internal Revenue agent in charge, and his assistant. [1313A]

Q. What was the subject matter of the hearing?

A. Just before the field man had completed his report, I addressed a letter to Mr. Krigbaum in which I outlined the facts concerning the taxpayer's claim for deduction, but without argument, and I appeared before Mr. Krigbaum and refreshed his recollection concerning the factual statement and argued that the loss was properly a 1943 loss and not a 1940 loss. Mr. Krigbaum stated that he was not at all sure that the agent might not be right in his proposed recommendation, and I then suggested that the matter be referred to Washington for an advisory ruling, and Mr. Krigbaum said that he would refer it there if I could find out if they considered the type of matter that they would give an advisory ruling on.

Q. Did you then confer with the office of the Commissioner of Internal Revenue in Washington?

A. I did. I talked with Mr. Nichols, Mr. Gayton, and others, and they stated they would be glad to give an advisory ruling if Mr. Krigbaum's office requested it.

Q. What was the next thing you did?

A. Well, I told Mr. Krigbaum of that and Mr.

(Testimony of James K. Polk.)

Krigbaum then forwarded the case to Washington. This took some little span of time.

Q. Did you have any conference with the office of the Commissioner of Internal Revenue in Washington after the advisory ruling had been requested by the Internal Revenue agent in [1314] charge?

A. After I found out the case had reached Washington I talked with Mr. Nichols, who was head of the post-audit review section, having the New York area, and reviewed with Mr. Nichols the facts in the case and the contention of the taxpayer that this was the 1943 deduction. Mr. Nichols then told me that he would refer the case in the usual course to his office force for consideration and preparation of an advisory ruling, and he promised me that in the event there was any disagreement with the positions of the taxpayer, that they would afford me a formal hearing.

Q. Following that did you learn of any action that the office of the Commissioner in Washington had taken?

A. The next thing I learned about the case was when I returned from San Francisco in December.

Q. December, 1946?

A. 1946. Mr. Herskowitz of the Internal Revenue agent's office called me up and said that they had received an advisory ruling stating that it was the opinion in Washington that the revenue agent's recommendation should be sustained.

Q. What did you do next, Mr. Polk?

(Testimony of James K. Polk.)

A. I went down to Washington to find out about it because I had been promised a hearing in the event an adverse ruling were to be given, and I found out that the ruling had originally been drafted in favor of the taxpayer's contention, but it had [1315] been changed in the front office without knowledge that the conference had been promised and had not been afforded me. So they agreed that if the matter were resubmitted to them, they would afford me a hearing.

Q. And were you in fact afforded a hearing?

A. I was.

Q. Was that a formal hearing?

A. That was a formal hearing.

Q. And when was it held?

A. On February 11, 1947.

Q. And where?

A. In the office of Mr. Edingfield, Technical Advisor to the Commissioner of Income Tax.

Q. That is in the Treasury office in Washington?

A. In Washington, yes.

Q. Who was in the hearing?

A. Mr. Edingfield presided, and Mr. Nichols, and some man whose name I cannot remember from the Securities Valuation Section, were present representing the Government; Mr. Noneman, Mr. Whiteside and I represented the taxpayer.

Q. And Mr. Whiteside is a professor in the University of Cornell law school and an associate from time to time of your firm?

(Testimony of James K. Polk.)

A. That is right.

Q. Will you please tell us what took place at the conference. [1316]

A. Well, I first reviewed the facts in considerable detail, both as to the origin of the loss, the basis, then I discussed what I thought were the applicable cases which sustained the taxpayer's contention that the deduction was a 1943 deduction. I discussed at some length the Haskins & Sells, Bretey and Graham reports, which established that the stock had value or was evidence that the stock had value, up to certainly April of 1943, when the preferred stock was delisted. I then urged that the Bureau should allow the deduction as a 1943 deduction. Mr. Edingfield at that point stated that he thought that there was considerable merit to the taxpayer's contention, but that the interests of the Government might best be protected by litigating the matter. I told Mr. Edingfield I thought this was a case that was particularly subject to administrative settlement, rather than litigation. Mr. Edingfield suggested——

The Court: Mr. Adams, I don't like to interrupt, but while this case is important and you should have all reasonable time to present it on both sides, there are other litigants that are entitled to be heard in these courts and are waiting to be heard, and I just cannot see what purpose is served by these long discussions as to what took place in a conference in Washington over subject matter,

(Testimony of James K. Polk.)

when the results are before the Court, and it doesn't seem to serve any useful purpose.

Mr. Adams: Your Honor, I am responsible for this; may I try and shorten that up in that case? I appreciate your [1317] Honor's suggestion.

Q. Mr. Polk, you have just come to the question of settlement. Now, at that conference, will you state what proposal of settlement was discussed, and tell us briefly about that. That is what we have to account here for.

A. Well, Mr. Edingfield asked what sort of a settlement could I suggest, and I said, "Well, the case might be settled by leaving the returns as filed, stand, unchanged." He asked me if I would put it in writing, and I told him I would get authorization and put it in writing.

Q. And you spoke of Professor Whiteside, and I did also. It is a fact, is it not, that Professor Whiteside worked with Colonel Coulson throughout the reorganization of the Western Pacific, or the latter part of that period?

A. Yes, I had Mr. Whiteside present to be sure that I accurately stated facts regarding the reorganization.

Q. Now, at this time, the time of this conference that you had in Washington, where was Colonel Coulson?

A. He was in San Francisco.

Q. Did you discuss the submission of the proposal of settlement with him?

(Testimony of James K. Polk.)

A. I immediately phoned him in San Francisco and told him of this development which had taken place.

Q. And did you receive a telephone call from San Francisco in respect of the proposal of settlement? And please state what [1318] that was, briefly, and whether or not through that telephone call you received authorization to go ahead.

A. I did, two or three hours later, receive a telephone call from San Francisco. I was advised by Colonel Coulson and Mr. Elsey that the directors had been canvassed and that I was authorized to submit the written offer of settlement, which I read over the telephone to them.

Q. Now, was anything said during either of these telephone calls as to the advisability or inadvisability of informing the plaintiff corporation about the offer of settlement?

A. Nothing was said.

Q. Did you thereupon file the offer of settlement with the Commissioner?

A. I did, the same afternoon.

Q. And that document is in the record.

I think all counsel will agree that a copy of it appears as a part of Plaintiff's Exhibit 68, being a document dated February 11, 1947?

Mr. Phleger: It is so agreed.

Q. (By Mr. Adams): Now, when, if at any time, did you learn that the proposal of settlement had been referred by the Commissioner of Internal

(Testimony of James K. Polk.)

Revenue to the Internal Revenue agent in charge in New York? A. Approximately March 19.

Q. And when with respect to that date did you notify the plaintiff [1319] corporation of the submission of the proposal of settlement?

A. I think the letter to Mr. Curry was dated April 2.

Mr. Adams: And may the record show, by consent of counsel, that the letter is Plaintiff's Exhibit 68?

Mr. Phleger: Agreed.

Q. (By Mr. Adams): Did you thereafter discuss the matter with representatives of the plaintiff corporation? A. I did.

Q. What was the occasion, if any, for the delay in notifying the plaintiff corporation of the submission of the proposal of settlement?

A. Well, it was my first impression that the taxes which had been paid, and which would be paid, being the dollars of the company, that my responsibility was to them and not to the corporation. But I knew of the pending litigation, and after giving the matter consideration, I came to the conclusion that they should be notified. And when I came to that conclusion, I notified them.

Q. Now, had anybody at any time requested you to refrain from advising the plaintiff of the submission of the proposal of the settlement to the Bureau? A. No, sir.

Q. Did any representative of the plaintiff ever

(Testimony of James K. Polk.)

tell you that they thought the proposed settlement was disadvantageous as regards settlement with the Government? [1320]

A. I don't think I understand the question.

Q. Did any representative of the plaintiff corporation ever tell you that they did not believe the proposed settlement was a good one?

A. No, they did not.

Q. Now, Mr. Polk, what did you perceive your functions to be as tax counsel engaged in this work?

A. I thought my function was to advise concerning Federal tax matters in such a way as to produce the least tax liability for the group.

Q. Now, do you recall the commencement of the stockholders' action in New York, which we call the Van Kirk action, in the middle of the year 1946?

A. I was aware of it shortly after it was filed.

Q. Shortly after it was filed, did you examine the bill of complaint in that lawsuit?

A. I did not examine the bill of complaint, although certain portions of it were brought to my attention, and I did examine them with Mr. Shaw.

Q. Now, after you found out about that lawsuit in which there were controversies between the parties as to who was to get the so-called tax savings, did you believe that there was any possible conflict as far as your representation of the group was concerned?

(Testimony of James K. Polk.)

A. No, I believed my employment was to obtain the least tax [1321] liability possible under the facts and the Bureau of Internal Revenue laws and regulations.

Q. And did you believe it was any function of yours to give advice to any member of the group with respect to possible claims, one against the other? A. No.

Q. Now, did you have any other further knowledge with respect to the Van Kirk claim than what is set forth in the bill of complaint? A. No.

Q. Have you ever heard, or had you ever heard of such a claim prior to the time you learned about it through that complaint? A. I had not.

Q. Now, I hand you a copy of a letter identified as Plaintiff's Exhibit 7 upon the depositions, being a letter of September 27, 1946, addressed to your firm by Mr. Curry as president of the plaintiff corporation, together with a copy of your letter of October 4, 1946, addressed by you to Mr. Curry as such president, being Plaintiff's Exhibit 8-B.

And I ask that 8-A be handed up, please. And I will offer 8-A. It is a letter of October 5, 1946, from Mr. Curry as president of the corporation, to Mr. Nicodemus and Mr. Osborn, enclosing 8-B, which is a copy of Mr. Polk's letter to Mr. Curry. I shall offer these documents in evidence, your Honor; the letter of September 27, 1946, from Mr. Curry to the firm [1322] reads:

(Testimony of James K. Polk.)

“In order to protect any equitable interests that the Western Pacific Railroad Corporation may have in the reserves set up by the Western Pacific Railroad Company on account of tax deductions, as well as any refunds of tax payments arising from claims filed with the corporation, we propose to file a bill of complaint in the District Court of the United States for the Northern District of California, Southern Division, asking that these reserves and refunds, if any, be impounded, pending an accounting and an equitable determination, to ascertain what, if any, interests the corporation may have therein.

Appreciating that your firm has acted as tax counsel for both the company and the corporation in the filing of consolidated tax returns and in the proceedings now pending before the Internal Revenue Department, we would, of course, not wish to take any steps which would in any way prejudice the claims made in these returns. We would therefore appreciate your advise on this, and would be glad to have any suggestions you may make for the full protection of the interests of the corporation therein. [1323]

I would be glad to arrange a conference between your Mr. Polk and our counsel to discuss the matter further.

Yours very truly,

President.”

(Testimony of James K. Polk.)

Plaintiff's 8-A is a letter of transmittal from Mr. Curry to Mr. Nicodemus, and Mr. Osborn, dated October 5, 1946, transmitting a copy of Mr. Polk's reply to the letter I have just read, and Plaintiff's 8-B is Mr. Polk's reply, addressed to Mr. Curry, President of the Western Pacific Railroad Corporation, October 4, 1946:

"Dear Sir:

This refers to your letter of September 27, 1946, addressed to this firm. The undersigned has been acting as tax counsel in connection with pending tax questions arising under the Federal consolidated returns made by the Western Pacific group for the period ended April 30, 1944, and prior open years.

In presenting the issues as to these tax matters to the Treasury Department, it will be necessary to develop the facts fully, and the Treasury Department is clearly entitled to any relevant information. There would therefore seem to be no reason why any development of facts in a [1324] separate litigation instituted by your company in the United States District Court in California would present necessary embarrassment in connection with the tax questions."

The Clerk: No. 37.

Mr. Adams: I offer the three documents as Defendants' Exhibits 37-A, -B and -C.

(Letter, September 27, 1946, Curry to Whitman, Ransom, Coulson & Goetz; October 5,

(Testimony of James K. Polk.)

1946, Curry to Nicodemus & Osborn, and October 4, 1946, Polk to Curry, were received in evidence and marked Defendants' Exhibits 37-A, -B and -C.)

Q. (By Mr. Adams): Now, Mr. Polk, with respect to the proposal of settlement that had been submitted on February 11, 1947, in Washington, when did you learn that that proposal had been communicated to the Revenue Agent in charge in New York?

A. That was approximately March 19, as I stated, 1947.

Q. And thereafter, with respect to that proposal of settlement, when did you learn that the Internal Revenue Agent in charge in New York had acted upon it?

A. That is sometime around the middle of June, 1947.

Q. Did you advise the plaintiff and the defendant in this suit—that is, the Western Pacific Railroad Corporation and the Western Pacific Railroad Company—of the action taken by the Internal Revenue Agent in charge? A. I did.

Q. And was that action favorable to the proposal?

A. It was; it contained a recommendation for a settlement of the case in accordance with the proposal.

Q. Approximately when did you learn of that case? Can you fix the time approximately?

(Testimony of James K. Polk.)

A. It is around June 15 of 1947.

Q. Was it in the same month that you notified the plaintiff and the defendant?

A. Yes, immediately thereafter.

Q. Tell the Court—you spoke of that as favorable action—what it came to; that is to say, was the action of the Internal Revenue Agent in Charge final or was it an intermediate step that went forward?

A. That was an intermediate step. The case had then to go to post-audit review in Washington for final action.

Q. Did you thereafter learn of the final action being taken on the proposal? A. I did.

Mr. Adams: Your Honor, that final action is exemplified by the papers attached to the stipulation on file in this court.

The Court: Yes.

Mr. Adams: Your Honor will recall the first of the letters from the Commissioner was dated August 13, 1946.

Q. When, if you recall, Mr. Polk, did you learn of the Commissioner's action on August 13, 1946?

A. August 14.

Mr. Phleger: You mean 1947.

Mr. Adams: I do.

The Witness: August 14, 1947.

Q. (By Mr. Adams): Now, Mr. Polk, prior to the discussion which you had at the office of the Commissioner of Internal Revenue on February

(Testimony of James K. Polk.)

11, 1947, had there been any prior discussion on your part with respect to any possible settlement?

A. No, sir.

Mr. Adams: I have no further questions.

Cross-Examination

By Mr. Phleger:

Q. Mr. Polk, are you tax counsel for the defendant? A. I am.

Q. You and your firm? A. That is right.

Q. When did you cease to be tax counsel for the plaintiff?

Mr. MacKinnon: Your Honor, we submit——

Mr. Phleger: Now——

Mr. MacKinnon: I can make an objection. I certainly can do that. I object to the question on the ground that it calls for a conclusion of law. Your Honor will determine the question. He was representing the affiliated group. He is now asking when he ceased to be counsel for the plaintiff corporation. His only representation was as a representative of the [1327] affiliated group. That is a question of law for your Honor to determine.

The Court: I will overrule the objection.

The Witness: Well, I do not recall any questions on Federal taxes being asked me after the 1945 return was filed. There have been questions asked me on State taxes. Mr. Curry sent such a question to my office within the last six months.

Mr. Phleger: Will you read the question again, Mr. Reporter.

(Testimony of James K. Polk.)

Mr. Adams: I submit it is responsive, your Honor.

Mr. Phleger: I do not think so.

Q. Are you still tax counsel for the plaintiff?

A. I still am, as far as I know, for the years covered by the powers of attorney which are on file with the Government.

Q. Do you still consider yourself tax counsel for the plaintiff with respect to all the matters that are in controversy here?

Mr. Adams: If your Honor please——

Mr. Phleger: Just a minute now.

Mr. Adams: I can make an objection.

Mr. Phleger: I object to objections which are suggestionized in their form.

Mr. Adams: That is a sound objection, but it is made before the objection has been heard.

Mr. Phleger: It applies to the last objection.

Mr. MacKinnon: I do not think there was anything suggestive [1328] in the form of my objection. I have a right to state the basis of my objection in any objection I make.

Mr. Adams: May I hear the question to which I was about to make an objection?

(Question read.)

Mr. Adams: I object, your Honor, upon the score of calling for a conclusion of law and its immateriality as to any issue involved in this case, it appearing on the facts before your Honor who

(Testimony of James K. Polk.)

are the parties and who are their representatives.

The Court: I should think a lawyer should be able to say whether he represents a client or not. I do not think that calls for any conclusion of law. I will overrule the objection.

The Witness: I have not been called upon at all by the plaintiffs, as I have stated, with the one exception that I mentioned, oh, for two years.

Mr. Phleger: I submit that is not responsive. Mr. Reporter, will you read the question.

The Court: I think that the subject of the inquiry is not whether the corporation has made any legal inquiries of you for information, but whether or not there is any relationship now in existence of a contractual or other nature in which you are employed by the corporation.

A. I know of no contractual relationship by which I am now [1329] retained by the corporation.

Mr. Phleger: I will narrow the breadth of that.

Q. Are you the plaintiff's attorney?

A. I—I do not think so.

Q. When did you cease to be the plaintiff's attorney?

A. Well, when they ceased asking for advice or coming to me. There was no written contract or annual retainer at any time. I acted on requests for information or on work to be done as it was given to me, and when they stopped giving me the work, I assumed that I stopped acting as their attorney.

Q. Well, when was that date?

(Testimony of James K. Polk.)

A. My recollection, I have told you, except for this one matter Mr. Curry referred to me, I do not think I have had anything to do for the corporation for two years.

Q. That date would be what in 1945—or 1947?

A. 1947.

Q. Can you fix the date?

A. I cannot.

Q. As a matter of fact, all of these negotiations for settlement with the Government that you related were all conducted in the name of the plaintiff corporation, were they not?

A. Oh, that is correct.

Q. By yourself as attorney in fact?

A. Under power of attorney.

Q. Yes. [1330] A. Right.

Q. And in its name?

A. And in the name of the common parent corporation, yes.

Q. That is the plaintiff corporation?

A. Right.

Q. Did you have a power of attorney from anyone else?

Mr. Adams: You mean in relation to the matter now in controversy?

Mr. Phleger: Correct.

A. Yes, I had powers of attorney from the other members of the affiliated group.

Q. But you conducted all the negotiations in

(Testimony of James K. Polk.)

the name of the plaintiff corporation under the power of attorney which you have testified you prepared and submitted to Mr. Curry for signature, is that correct? A. That is correct.

Q. I think you testified that you made the offer in behalf of the plaintiff corporation and the affiliated corporations in February of 1947, and that you notified the plaintiff corporation for the first time sometime in April, is that correct?

A. That is correct.

Q. Where was Mr. Curry's office during all this time?

A. I think it was in our office at 40 Wall Street.

Q. Well, you know it was, don't you?

A. Yes. [1331]

Q. How far from your office?

A. Oh, it was six or eight offices removed. I can't tell you how far.

Q. 50 or 60 feet? 40 or 50 feet?

A. Well, probably.

Q. 40 or 50 feet away from your office. Now, did you keep Mr. Curry currently advised of these other matters that you have testified to, the writing of the first Krigbaum letter, the second Krigbaum letter, and the Nunan letter?

Mr. Adams: Could you give the witness an identification of something that you have names for and he has not been——

The Court: He may be able to place them without taking a lot of time to refer to the exhibits. If the witness needs them he may have them.

(Testimony of James K. Polk.)

Mr. Adams: It is just a question of identification.

The Court: Do you know what Mr. Phleger is referring to?

A. I can find out very quickly. The first Krigbaum letter——

Q. (By Mr. Phleger): ——is the general explanation.

A. That is the May 25 or thereabouts letter?

Q. Yes.

A. And the second Krigbaum letter——

Q. The first Krigbaum letter is May 31, 1946; the second Krigbaum letter is a year later, May 19, 1947. Did you advise Mr. Curry of the sending of those letters at or about that time or [1332] at all? A. No.

Q. Did you advise Mr. Curry about the sending of the Nunan letter at or about its time?

A. Is that the February 11 letter?

Q. Correct.

A. I advised him of the sending of that letter on April 2, 1947.

Q. Now, you stated in your direct testimony that you had to have the power of attorney in order to deal with Krigbaum, didn't you?

A. I did.

Q. Have you in mind that you did not get the power of attorney until a month after you wrote the first Krigbaum letter?

A. The letter was addressed to Mr. Krigbaum

(Testimony of James K. Polk.)

but was delivered to Mr. Leahy. Mr. Leahy used it in the recital of facts, in the report that he had in the course of preparation. It had to be addressed to his chief, and not to the Revenue Agent.

Q. You wrote that letter and signed it in the name of the plaintiff corporation before you had the power of attorney, didn't you? A. I did.

Q. I will direct your attention to the 1942 return. When did you decide to file a consolidated return for the year 1942?

Mr. MacKinnon: I object to the form of the question. He [1333] said, "When did you decide." There is no evidence that the witness did make the decision.

Mr. Phleger: Well, he can answer it. It is a proper question.

Mr. MacKinnon: I do not think it is proper. That is why I objected to it.

The Court: I will overrule the objection.

A. Well, sometime between April 1 and May 15, 1943, the calculations were made which showed the advisability of the consolidated return, the advantage of the consolidated return over the separate return, and advice was given at that time, of course, to file on the basis which reflected the lower tax.

Q. (By Mr. Phleger): And you place that time as what time in 1942?

A. I cannot place the time by day.

Q. No.

A. I know that it was along toward the latter

(Testimony of James K. Polk.)

part of the work that was done in the preparation of the return, because the calculations could not be made until some progress had been made in converting back figures to tax figures.

Q. And Reilly made those figures, did he, for you? A. He did.

Q. Have you got the figures?

A. I do not know. They were summarized in the letter of May 20, but I do not believe that the actual calculations have been located. [1334]

Q. When in 1943 did you first begin to take an interest in the tax affairs of the plaintiff corporation and its affiliated corporations?

A. I received a memorandum of inquiry from Colonel Coulson sometime around the 15th of March, 1943, in which he stated that he understood that the returns were being prepared by some woman over in the corporation office and asked me to look into the matter. I phoned the office, talked with someone there—it is my recollection it was Mr. Curry—he said that that was the fact, and the papers had just been received from the West Coast, and it would be six weeks or a couple of months before the return preparation would be completed.

I made a memorandum of that on the bottom of the paper and sent it back to Colonel Coulson and my—I think that answers your question.

Q. That memorandum, Mr. Polk, reads as follows:

(Testimony of James K. Polk.)

“Colonel Coulson:

As I understand the procedure in the New York office, only the lady referred to has any part in the preparation of the return. She now has separate company data and will require several weeks to prepare consolidated schedules. She ‘confers’ with accounting firm, but Mr. Curry says they are too impoverished to hire accounting help. They paid on 3-15 a quarterly payment of \$1,000,000. [1335]

No decision has been reached as to depreciation treatment. I will follow this up if you so direct in about four weeks.”

You recall that, do you not?

A. I do.

Q. And do you recall then a memorandum from Mr. Coulson to you: “Better follow up”?

A. I know that that notation is on there. I have no independent recollection of it, sir.

Q. At that time you or your firm were not the attorneys for either the defendant or the plaintiff or the trustees in bankruptcy, were you?

Mr. Adams: You mean in tax matters, Mr. Phleger?

Mr. Phleger: Yes, in tax matters, in these matters.

A. No, sir.

Q. You became attorney after you made this inquiry?

A. That is right.

Q. Do you know, Mr. Polk, of any similar case to this, that is, where the parent’s stock loss in a subsidiary was used in a consolidated return to eliminate the tax for the affiliated group?

(Testimony of James K. Polk.)

A. No, I have no personal knowledge.

Q. Well, you never heard of any such case, did you?

A. Well, the way you stated it, it is a rather usual circumstance. [1336]

Q. Well, you state it. You are an expert.

A. I know, but you state where the parent's loss has been used to offset system income, that is a rather usual circumstance.

The Court: He means the parent's loss of its own stock in a subsidiary.

Q. (By Mr. Phleger): Yes, its ownership in the subsidiaries.

A. I know of no such case.

Q. As a matter of fact, this case could not have happened except for a change in the law in October 1942, could it?

A. No, it could not have.

Q. What was that change in the law which made this possible?

A. Well, there was a very unfair situation in consolidated return accounting up to that point that section 23(g)(4) was designed to correct. You see, under consolidated returns intercompany transactions are eliminated, and where a parent corporation puts out its cash for a subsidiary company and then the subsidiary company becomes worthless, if you eliminate the worthlessness as an intercompany transaction, there has been, in the usual case, a deprivation of capital, a loss of

(Testimony of James K. Polk.)

capital and no reflection for tax purposes, and that was corrected by the insertion into the Internal Revenue Code of Section 23(g)(4).

Q. So that my statement is correct, is it not, that this particular tax handling became possible because of the new law passed [1337] in October of 1942?

A. It was the Revenue Act of 1942, yes, sir.

The Court: Perhaps we might take a recess at this time.

(Recess.) [1337-A]

Q. (By Mr. Phleger): Mr. Polk, when was the first time it was decided to use the stock loss?

A. In late December 1943, I had reached the conclusion that I would recommend its use. In January of 1944 I did recommend its use and the decision was made to use it.

Q. Who made the decision?

A. Mr. Elsey, Mr. DeGraff.

Q. Where was it made?

A. Made in San Francisco.

Q. When was it decided to file a consolidated return including the defendant corporation for the first four months of 1944?

The Court: You mean the defendant corporation?

Mr. Phleger: A consolidated return of the plaintiff, including the defendant corporation for the first four months of 1944.

(Testimony of James K. Polk.)

Mr. Adams: Your Honor, I understand I have a running objection to the characterization due to the fact that we represent the reorganized company, which came into existence the first of 1945, and questions of this sort are subject to such a running objection.

Mr. Phleger: Well, Mr. Adams, the returns were filed in the name of the defendant corporation, were they not?

Mr. Clark: The plaintiff corporation.

Mr. Adams: The 1944, the first four months of 1944 were filed in the name of the plaintiff, and the last eight months [1338] were filed by the defendant corporation.

Mr. Phleger: Yes, but the participance in the first four months was in the name of the defendant corporation, was it not?

Mr. Adams: As it had always been throughout the trusteeship.

Mr. Phleger: Well, that is the question. Would you read the question?

(Previous question read by the reporter.)

A. I am not sure I can answer that. I can't tell you when I decided to recommend that.

Q. When was that?

A. That was shortly after the transfer of the stock, April 30, 1944, which terminated the affiliation.

Q. To whom did you make the recommendation?

(Testimony of James K. Polk.)

A. The recommendations were ultimately made to Mr. Elsey, Mr. DeGraff, Mr. Curry prepared the returns in accordance with them, and so forth.

Q. And they made the decision?

A. The decision to file the returns were, of course, made by the company.

Q. Yes. Now who made the decision to file a claim for refund for 1942?

A. Decision?—I prepared the claim for refund, and saw that it was finally filed.

Q. Well, who made the decision to file it? [1339]

A. Well, I guess that decision was made by Mr. Curry, who signed it.

Q. Well now, Mr.—

A. Well, you asked who made a decision to file it. I recommended and prepared the claim, which is a technical step to protect the interests of the group in the transaction, and sent it forward for execution by the proper signing officers, and it was executed and filed.

Q. Well, you prepared it on your own initiative, did you not? A. Certainly.

Q. And when you prepared it, had you discussed it with anyone in the corporation, the matter? A. No.

Q. And you sent it forward with the request that it be signed, did you not?

A. I did.

Q. Now you have stated at some length as to the circumstances surrounding the submission of

(Testimony of James K. Polk.)

the so-called Nunan offer, which was in February, 1947. Other than the power of attorney which you had received a year or more earlier, had you any authorization from the plaintiff corporation to make that offer in its name? A. No.

Q. During this entire period, did you give any advice to any officer of the corporation as to what its right might be as against any other officer of the affiliated group arising out of the [1340] filing of consolidated returns? A. No.

Q. Did you ever advise anyone representing the corporation, the plaintiff, that it could elect to file or not file consolidated returns?

A. Will you read that to me?

(Previous question read by the reporter.)

Mr. Phleger: No, strike that out.

Q. Did you ever advise anyone representing the corporation during this period it had the option to file or not file consolidated returns?

Mr. Adams: I object to the question, your Honor. Our contention being that there was no option under the circumstances, and it was obligatory on the part of plaintiff corporation to file returns which were filed.

The Court: Well, of course that is argument in the matter.

Mr. Adams: That is right. I state it in my objection.

The Court: All the question pertains to is a question of fact. Overruled.

(Testimony of James K. Polk.)

A. Well, I don't believe that I advised anyone in that form. I did advise in respect specifically of the 1942 tax returns, that the consolidated basis was a great deal less than the separate basis. It was quite apparent to everybody that we could have filed on either basis.

Mr. Phleger: Now will you read the question, Mr. Reporter, [1341] please?

A. I would like to complete my answer by stating that the same type of disclosure of advantage of consolidated over separate return was made for the year '43 and for the four months of '44.

Mr. Phleger: Would you read my question, please?

(Previous question read by the reporter.)

Mr. Adams: May we have the answer, your Honor?

Mr. MacKinnon: Yes, I would like to hear the answer.

The Court: You may during this period, Mr. Phleger?

Mr. Phleger: I mean during this entire period involving the returns for these years.

The Court: All right. Do you wish the answer, gentlemen?

Mr. MacKinnon: Yes.

Mr. Phleger: Well, he didn't answer this question.

Mr. MacKinnon: I assumed he did. I take the position that he did answer it. I think it is a

(Testimony of James K. Polk.)

responsive answer. It may not be what counsel wishes, but that is immaterial.

The Court: Well, if they want it, you may as well read it.

(Previous answer read by the reporter.)

Mr. Phleger: I submit the question has been answered. The question is, "Did you, during this period, with respect to this period, advise the corporation that it had the option to file or not file consolidated returns?"

Mr. Adams: I submit the question was answered directly.

The Court: Well, the first part of the question is in [1342] answer to it. He said he didn't.

Mr. Phleger: Well, if that is the answer, that he didn't——

Mr. Adams: I take it, your Honor, the answer was in respect of the privilege to explain the witness' answer.

The Court: Well, of course, he gave part of it——part of it is his conclusion and opinion, as to whether everybody assumed something or not. That is, of course, his opinion and conclusion.

Mr. Phleger: That is right. But do I understand your Honor to interpret his answer is that he said——

The Court: He said he didn't do it in that form, which means that he didn't do it.

Mr. Phleger: All right.

The Court: Because your question was a specific

(Testimony of James K. Polk.)

question, I am not attempting to shut you off; you can pursue it as far as you want to.

Mr. Phleger: Well, the witness hears your interpretation of the answer, and I accept it.

The Witness: Well, I didn't mean my answer to be so interpreted.

Q. (By Mr. Phleger): Well, suppose you answer the question, then?

Mr. Adams: Move to strike out that remark of counsel's; it is inappropriate to this record.

The Court: Well, the question was a narrow one. The [1343] attorney wanted to know whether you advised anyone connected with the corporation that the corporation, during this period of time, had the option to file or not to file any affiliated returns.

The Witness: Well, your Honor, that was perfectly apparent when I discussed with them——

The Court: It may be. Now that is a matter that I am going to have to decide. All he wants to know is whether you, from your own mouth, by word of mouth or in writing, specifically so told any of the officers of the plaintiff corporation. Now there are a lot of lawyers here that are going to carry it further, I suppose. But that you can answer.

The Witness: Very well.

The Court: And you don't have to be afraid to answer it because it may be there is some other evidence to show that they did not know that. But all

(Testimony of James K. Polk.)

he is asking you is whether you told them that. That is all.

The Witness: Well, when I discussed the advisability of filing one or the other, it was perfectly apparent that they understood that they could have filed either of them.

Mr. Phleger: I move that be stricken out and that the witness answer the question.

The Court: Yes, it may go out. That still may come into the case, but all you are being asked is whether, at the time you told them that. [1344]

A. Very well, sir.

Q. (By Mr. Phleger): Will you answer the question?

A. I have answered it as well as I can, sir.

Mr. Phleger: Will you read the question, Mr. Reporter?

(Previous question read by the reporter.)

The Court: It is not a question of whether you considered it necessary to do that; but in fact, did do it.

A. Well, I certainly considered that I had.

Mr. Phleger: Well, I move that that be stricken out.

The Court: Yes. That may go out.

Mr. Phleger: And that he answer the question.

A. It is my belief that I did.

Mr. Phleger: Now I would like the deposition of this witness, page 1985.

(Testimony of James K. Polk.)

(Deposition produced by clerk.)

Q. (By Mr. Phleger): I read to you from your deposition, page 1985, about eight lines from the bottom of the page:

“Q. In connection with the preparation and filing of the 1944 tax, did you advise the corporation that the corporation could elect to file a non-consolidated return for that year?

“A. I did not.”

Do you recall that testimony?

A. Well, I don't recall all that I said on deposition, no, sir.

Q. Well, was that statement true when it was made? [1345]

A. Well, it is my present recollection, as I have tried to testify that Mr. Curry, an officer of the corporation, was advised of the type of return and reason for filing that type of return, as against a separate return, as each return was prepared—'42, '43, and '44. Now that is the fact; what that amounts to I cannot say. I am not attempting to testify——

Q. Well, you have been asked the direct question as to whether you advised them—that is, the plaintiff corporation—that they had the option or election to file or not to file a consolidated return. Now what is your answer?

Mr. MacKinnon: I submit, your Honor, that that is a different question than was asked previ-

(Testimony of James K. Polk.)

ously, and I object to it on the ground that, if it is purported to be the question that was previously asked, the previous question, if I recall, was "anyone connected with the plaintiff corporation." Now he says the "plaintiff corporation."

Mr. Phleger: Well, I see no difference.

The Court: I will overrule it.

Mr. MacKinnon: I see a material difference.

The Court: Overruled.

The Witness: You are not excluding Mr. Curry in that connection?

Mr. Phleger: No.

A. I gave no written opinion on that to anyone. I was not asked the specific question, so far as I can recall, by anyone. [1346] It was discussed and decided as an available alternative method of filing in each year, and the decision was to file on the basis which produced the least tax.

Q. And that is the only answer you can make to my direct question as to whether you advised?

A. That is.

Q. And you want the record to remain in that shape. You know during all this time that the plaintiff corporation could elect to file a separate return if it saw fit, did you not?

A. Well, I would have so advised. There are lots of periods during this time that you are talking about when they could not have, sir. You realize that this was not a continuing new election each year. It was something that came up by way of

(Testimony of James K. Polk.)

the commissioner's authorization at varying dates, so there were considerable periods when there was no election available. Having once filed the consolidated returns, you were bound by it.

Q. Having made that qualification, will you answer the question?

Mr. Adams: I object to the question as stated.

The Witness: I just can't answer your question. It is not so, that they had a free election all during this period.

Q. (By Mr. Phleger): Is it not a fact that you knew that at each time a consolidated return was in fact filed for 1942, 1943 and 1944, that the corporation at the time of filing had an election not to file a consolidated return but an individual return? You knew that, didn't you? [1347]

Mr. Adams: Your Honor, I object to that. I contend the statement in the question is inaccurate. That is an issue in this case. Your Honor appreciates one of our contentions is directed to the contrary, and counsel is asking of this witness a question which is an issue of law before your Honor.

The Court: He is only asking him as to what his knowledge was in the matter. Overruled.

The Witness: I think at the time each return was in fact filed that there existed the election to file either separate or consolidated returns.

Q. (By Mr. Phleger): Mr. Polk, when in your opinion did it become clear for the first time that the tax loss would be accepted by the government?

(Testimony of James K. Polk.)

A. August 14, 1947, sir. I do not mean to be facetious, but this was a doubtful item and it was not until the Bureau had finally allowed the settlement that I knew that we had the benefit of it.

Q. As a matter of fact, you considered any litigation about the tax benefits premature prior to that date, isn't that right?

Mr. MacKinnon: That is objected to, your Honor, on the ground it is irrelevant and immaterial to any issue in this case.

Mr. Adams: And this witness' opinion on a question of law of that sort is wholly irrelevant, your Honor.

Mr. Phleger: He is your attorney, acting for both parties at this time. [1348]

The Court: I do not think it is necessary to argue it. I think it is within the reasonable limits of proper cross-examination. Overruled.

The Witness: May I have the question read.

(Question read.)

A. I considered any estimate of the amount of savings premature prior to that date.

Mr. Phleger: I would like the witness' deposition, please, page 2496.

Q. I read now from your deposition, page 2496, about eight lines from the bottom. It has to do with a conference in which the settlement with the government was being discussed:

"Q. Were you discussing in those conferences the amount which is the subject matter of the liti-

(Testimony of James K. Polk.)

gation in California as affected by the settlement?

"A. That is not quite clear to me, sir.

"Q. What was the relationship between the subject matter that you described as having been discussed at this conference and the litigation in California?

"A. I think I was raising the question that any action was premature until the liability to the government was determined. You cannot calculate any savings until you know several factors, and one of the most important ones is the liability under the returns as filed."

Did you give that testimony that I have just read?

A. Yes, sir.

Q. Was it true when given? A. Yes.

Q. Is it true now? A. Yes.

Q. On your direct testimony—

Mr. MacKinnon: I want to submit the very next question and the very next answer, which was not read.

Mr. Phleger: I will be glad to read them.

The Court: You can take that up on redirect if you wish.

Q. (By Mr. Phleger): Mr. Polk, on your direct testimony you testified that you, after some thought on the subject, decided that you would advise the plaintiff corporation of the offer of settlement which you had made in its name and as its attorney in fact on February 11, 1947, and that you thereupon

(Testimony of James K. Polk.)

wrote a letter to the plaintiff corporation so advising it under date of April 2, 1947; do you recall that testimony? A. Yes.

Q. Did you write that letter?

A. I dictated the letter.

Q. How did you dictate it?

A. I dictated it to Mr. Noneman.

Q. Over the telephone? A. That is right.

Q. Where were you at the time? [1350]

A. I was in San Francisco.

Q. So you dictated this letter from San Francisco to your partner in New York and he wrote the letter and signed your name, is that right?

A. May I see the letter? I thought it was signed with the firm's name, but it may be my name.

Mr. Adams: Plaintiff's Exhibit 68, I believe.

The Court: That is just a copy of it.

Mr. Phleger: Yes, the copy shows signature by James K. Polk, if it is a correct copy.

Mr. Clark: It is conceded to be correct, your Honor.

The Witness: I do not suppose it is incorrect. I do not know.

Q. (By Mr. Phleger): This is the letter that you read over the telephone from San Francisco with the request that it be sent, is that not so?

A. Yes, yes, that is so. But I mean as to signature, whether it is James K. Polk or Whitman-Ransom, I do not know.

Q. It is your letter, isn't it?

(Testimony of James K. Polk.)

A. Yes, it is my letter.

Q. Did you dictate this letter over the telephone from San Francisco after conference with the attorneys in this litigation?

Mr. Adams: May I have that question read?

(Question read.)

The Witness: You mean on the subject matter of the letter [1351] or just in point of time?

Q. (By Mr. Phleger): Both.

A. It was after conference with Mr. Matthew and Mr. Adams, but the conference was not on the subject matter of this letter.

Q. It was about this litigation in part, wasn't it?

A. Oh, yes, yes.

Q. And after you had conferred about this litigation, you concluded then that you had better advise the plaintiff corporation?

A. In point of fact, that is correct.

Mr. Phleger: That is all.

The Court: Any questions?

Mr. Clark: Just a few, your Honor.

Cross-Examination

(Intervenors)

By Mr. Clark:

Q. Mr. Polk, did you get Mr. Coulson's authorization before you prepared the January 11, 1944, opinion which is in evidence in this case?

A. Approval of what, sir?

Q. Did you get Mr. Coulson's authorization be-

(Testimony of James K. Polk.)

fore you prepared the January 11, 1944, opinion which you have testified you gave to Mr. Elsey?

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any question in the action.

Mr. Clark: I will submit the objection, your Honor. The witness testified under direct examination——

The Court: I will overrule the objection. [1352]

The Witness: I can best answer that by relating the exact facts as I recall them.

Q. (By Mr. Clark): Will you please answer the question?

A. Well, I did not get Col. Coulson's approval to anything, sir.

Q. I asked whether you got his authorization before you prepared the opinion which you gave the defendant company.

A. You mean authorization to give them an opinion?

Q. Yes, sir. A. No.

Mr. Clark: May it please your Honor, I will offer in evidence a copy of telegram, James K. Polk to R. E. Coulson, dated January 10, 1944, having been marked Interveners' Exhibit 118 on deposition.

Mr. MacKinnon: May I see it, please?

Mr. Clark: The authenticity of which has been conceded.

Mr. MacKinnon: I object to it on the ground

(Testimony of James K. Polk.)

it is irrelevant and immaterial to any issue in the action.

Mr. Clark: The only portion of the telegram I am concerned with, your Honor, reads as follows:

"As basis for closing 1943 book entries, letter requested from firm as to effect of stock loss deduction in consolidated return on railroad company tax liability stop I will prepare letter if you authorize by wire."

We will submit the offer.

The Court: It may be introduced. [1353]

(The telegram referred to was thereupon received in evidence and marked Interveners' Exhibit No. 20.)

Q. (By Mr. Clark): At that time, Mr. Polk, did Mr. Coulson instruct you that the opinion should be held before becoming effective until cleared by him?

Mr. MacKinnon: I object to it on the ground it is irrelevant and immaterial to any issue.

Mr. Clark: I will submit it.

The Court: I do not know exactly what you are getting at. Are you making some distinction between the lawyers in the same firm?

Mr. Clark: I do not intend to. I intend to show there was no distinction, your Honor. There has been testimony in this case that Mr. Polk was the person who was relied upon, and that he had a certain conception of his duties. Also in his direct examination Mr. Polk testified the only reason the

(Testimony of James K. Polk.)

opinion was held up or sent to New York, or rather, clearance from New York was requested was because he did not have certain data out here. My point is it was cleared with Col. Coulson, the head of the firm, and it was a firm proposition.

The Court: Overruled.

Q. (By Mr. Clark): Did Mr. Coulson instruct you to hold up the opinion until he cleared it from New York?

A. I recall an arrangement, but I recall no instructions.

Mr. Clark: We will offer in evidence, if it please your [1354] Honor, a memorandum dated January 13, 1944, signed J. K. P., which is conceded to be Mr. Polk's initials, which is heretofore described as Interveners' Exhibit 178 on deposition, the only part of which I am interested in reading as follows:

"There was delivered to Mr. Elsey the letter of January 11 to be held by him per instructions of Col. Coulson until Mr. Elsey had telegraphic clearance from Col. Coulson in New York."

Mr. MacKinnon: I object to the letter on the ground it is irrelevant and immaterial to any issue in the action, and I state again to your Honor, that this is a situation where he takes two documents—these are only two out of many—and offers them. So if this extraneous matter is going in, there is no other alternative than to meet it.

The Court: Mr. MacKinnon, you have told me that a great many times during the trial of this

(Testimony of James K. Polk.)

case, and I am not going to admit or make ruling admitting or excluding evidence on the basis of some threat that that will cause the other side to produce any documents that you consider proper in product any documents that you consider proper in the case, and if it is proper and material I shall admit it.

Mr. MacKinnon: I am objecting to it on the ground it is irrelevant and immaterial.

The Court: I will overrule the objection.

(The document referred to was thereupon received in [1355] evidence and marked Inter-veners' Exhibit 21.)

Q. (By Mr. Clark): Mr. Polk, directing your attention to the conference at Denver, or rather, the meeting at Denver in June of 1943 with Mr. Schumacher and Miss Valouch in this business car of the railroad which you testified to in your direct examination, will you state whether or not at that time you advised Miss Valouch concerning the allocation of 1942 taxes in accordance with the rule then followed by the Securities and Exchange Commission?

Mr. Adams: Your Honor, may I have that question read?

(Question read.)

A. It is my recollection that there was some discussion of the allocation of taxes, and that I called attention to the U-45 rule of the Securities

(Testimony of James K. Polk.)

and Exchange Commission, and said that when I got back east—I was going to San Francisco—when I got back east I would check further into the matter, particularly as to the rules of allocation approved by the Interstate Commerce Commission, the prescribed system of accounts or individual rulings if any existed.

Q. At that time were you familiar with rule U-45 B 6?

A. I have on my deposition testified that I was familiar with the version of it which I had in my own file. If that is the same as the rule which now exists, I am familiar with it. I furnished the copy of the text with which I was familiar.

Mr. Clark: Now, may it please your Honor, I will ask counsel [1356] for a stipulation that the following releases of the SEC, being numbers 4806, in the matter of the Consolidated Electric and Gas Company; 4329, in the matter of Consolidated Electric and Gas Company and the Islands Gas and Electric Company; and 4444, in re Consolidated Electric and Gas Company and Islands Gas and Electric Company, and release 5535, in re Cities Service Company, Cities Service Refining Company. I will ask for the stipulation that they were received, that is, copies of them, by the office of Whitman, Ransom, Coulson and Goetz on or about the dates the releases bear, these being cited in the briefs which have been filed before your Honor.

(Testimony of James K. Polk.)

Mr. Adams: Is that in a deposition?

Mr. Clark: That is in the deposition, and it was so conceded.

Mr. MacKinnon: What page?

Mr. Clark: I can furnish you with the page later, subject to correction.

Mr. Adams: Well, it is stipulated, subject to correction.

Mr. Clark: Will you so stipulate, Mr. MacKinnon?

Mr. MacKinnon: No, but I won't stipulate they came to the notice of Mr. Polk.

Mr. Clark: I am not asking for that. I am simply asking for a stipulation that those were received by the firm of Whitman, Ransom, Coulson and Goetz on or about the date of the releases, which range from January 3, or rather from June 1, 1943, [1357] through January 3, 1945.

Mr. MacKinnon: I will accept it subject to the qualification that if I don't find such stipulation in the deposition, I withdraw it. They represent it is in the deposition.

Mr. Clark: That is satisfactory to us, your Honor, and that is all for this witness. [1358]

* * *

JAMES K. POLK

resumed.

Mr. Adams: I assume the cross-examination has been completed. May I have the exhibits, please,

(Testimony of James K. Polk.)

handed in by the interveners upon the cross-examination of Mr. Polk? What I have reference to were the documents that were referred to in the stipulation obtained that they were in the files of Whitman, Ransom, Coulson & Goetz.

Mr. Clark: Those SEC papers, Mr. Adams?

Mr. Adams: Yes.

Mr. Clark: I didn't have them marked or offered, because they are cited in the briefs as legal authority.

Mr. Adams: May I have them?

Mr. Clark: You may certainly have them, the four of them.

(Handed to counsel.)

Mr. Adams: This refers, your Honor, to the SEC release described by Mr. Clark upon his cross-examination of the witness, or releases, rather, being releases dated July 28, 1943, Holding Company Release No. 4444; June 1, 1943, Holding Company Account Release No. 4329; January 3, 1944, Holding Company Account Release No. 4806; and January 3, 1945, Holding Company Release No. 5535. [1359]

Redirect Examination

By Mr. Adams:

Q. I will hand the documents to the witness and ask the witness to tell me the time, if at all, when any of these releases first came to his attention.

(Testimony of James K. Polk.)

A. It is my recollection that they were brought to my attention at the time of the taking of my deposition in New York in this proceeding, and that at some time after the institution of the Van Kirk action in New York, a summary of one of them was brought to my attention in connection with a law memorandum prepared by Mr. Cavanaugh.

Q. Your deposition was taken, I take it—well, the record shows—in the year 1948, and referring to the Van Kirk action, by that you mean the litigation commenced in the middle of 1946 in New York? A. That is right.

Q. And prior to that time, that earlier date, had you ever had any knowledge concerning these releases or any of them? A. I had not.

Mr. Adams: Now, your Honor, referring to the portion of the deposition read upon the cross-examination by plaintiff's counsel, I desire to read what immediately follows, two questions, two answers.

Mr. Levy: What page is that?

Mr. Adams: Page 2497:

“Q. What were you referring to when you said ‘Any [1360] action was premature?’

A. Any action to recover a tax saving. It is impossible to compute the savings until you know what the tax liability is.

Q. Were you suggesting that the corporation's action could be defeated as premature upon that ground?

(Testimony of James K. Polk.)

A. Not at all. I was merely making the point that the case was still unsettled and that there was no way of saying what tax dollars belonged in any year."

Q. Do you recall giving that testimony upon the taking of your deposition, Mr. Polk?

A. I do.

Q. And were the answers which you then gave correct? A. They were.

Mr. Adams: Now may I see the exhibits, please, offered by interveners, the telegram of Januray 10?

The Court: Intervenors' No. 20.

Mr. Adams: Thank you, your Honor.

(Handed to counsel by the clerk.)

Mr. Adams: Your Honor, at this time I offer as Defendants' 38-A a telegram from Mr. Coulson to Mr. Polk of January 11, 1944, sent from New York and addressed to Mr. Polk, care of Charles Elsey, the Western Pacific Railroad Company, San Francisco.

(The telegram referred to was received in evidence and [1361] marked Defendants' Exhibit 38-A.)

Mr. Adams (reading):

"Your telegram tenth received"—

Mr. Clark: Just a moment, your Honor. How is that identified on the deposition?

Mr. Adams: Oh, thank you. Intervenors' 70-A.

Mr. Clark: Will you wait just a moment.

Mr. Adams: Surely.

(Testimony of James K. Polk.)

Mr. Clark: Very well.

Mr. Adams (reading):

“Your telegram tenth received. Have wired Hart my tentative plans. Ask Mr. Elsey’s office to try and arrange return space streamliner for February fifth. No success so far this end. Stock of operating company was not transferred to committee on December 31 owing to Delaware litigation. Think letter as to effect of stock loss deduction on consolidated return should be released from this office if possible. Suggest you draft and forward air-mail. Hope you are having a pleasant vacation.”

And I offer as Defendants’ 38-B a telegram of January 15, 1944, addressed from Mr. Coulson to Mr. Charles Elsey, President, Western Pacific Railroad Company, San Francisco, sent from New York. [1362]

(The telegram referred to was received in evidence and marked Defendants’ Exhibit 38-B.)

Mr. Adams (reading):

“We have reviewed opinion letter”——

Mr. Clark: The deposition number, please.

Mr. Adams: Oh, thank you. 71.

Mr. Clark: Very well.

Mr. Adams (reading):

“We have reviewed opinion letter of January 11 left with you by Mr. Polk. Have made some minor typographical changes, but approve substance and conclusions. Revised signed copy being mailed today to substitute for copy left with you.”

(Testimony of James K. Polk.)

The balance of the telegram does not relate to the opinion.

It will be stipulated, I think, that as upon the deposition, these telegrams were sent and received?

Mr. Clark: No doubt about that. The authenticity is conceded as to all these exhibits,—that one being signed “Coulson,” I believe?

Mr. Adams: Both of them being signed “Coulson.” Right.

Mr. Clark: Right.

Q. (By Mr. Adams): Now, Mr. Polk, have you ever known of a case in which a member of an affiliated group whose loss has been included in a consolidated return, with resulting tax advantage to other members of the group, but with no [1363] tax disadvantage to the loss company, has been compensated for joining in the return, that is, where such loss company has been compensated for joining in the return?

Mr. Phleger: Just a moment. I object to that upon the ground it is incompetent, irrelevant and immaterial, not within the scope of either the direct or cross-examination of the witness, an entirely different question.

The Court: Do you want this witness to decide this case for me?

Mr. Adams: Counsel for the plaintiff asked the witness a very broad question whether he ever heard of a case like this one.

Mr. Clark: Oh, no, that was not the question.

(Testimony of James K. Polk.)

The Court: He did not ask any questions along that line. He asked him whether he ever heard of a case where the affiliated return resulted in no taxes because the parent company was enabled to take the loss, the complete loss of its holding in the subsidiary company.

Mr. Adams: I take it, your Honor, this question is of a similar nature to that.

The Court: It is similar in that it is a question that involves taxes. That is as far as I can see. [1364]

* * *

The Court: I will sustain the objection. I think it is completely improper.

Mr. Adams: Your Honor, I have just one further question, somewhat like the last one. The last question asked the witness was if he had known of a case in which payment had been made for the tax advantage. That is the question to which objection was made and your Honor sustained the objection. Now, then, the next question varies slightly from that because the question was asked, "Have you ever heard of a claim," and I want to ask this one question:

Q. Mr. Polk, prior to the time that you learned of the stockholders' litigation in New York that was instituted in New York in 1946, had you ever heard of a claim on the part of a member of an affiliated group whose loss had been included in a consolidated return, with resulting tax advantage to other

(Testimony of James K. Polk.)

members of the group, but with no tax advantage to such loss company, to be compensated for joining in the return?

Mr. Phleger: I object to that upon the ground it is incompetent, irrelevant and immaterial and not within the [1368] scope of either the direct or cross-examination.

Mr. MacKinnon: May I make one more statement and I will sit down. I think this question is relevant, and I think the prior question was, on the basis of the discharge of this witness' responsibility to the plaintiff. If he did not believe that the plaintiff had any right to any share in the tax savings, then certainly his standard of conduct would be very different than if he did believe he had a right. If he knew or had come across a case of that type, then I think his standard of conduct with respect to the plaintiff would be a very different standard than it would be if he had never heard of any such claim and he had never heard of any compensation having been paid.

The Court: I think it is entirely incompetent what the witness' view or knowledge or effect of what he was doing was.

Mr. MacKinnon: That has been put in issue.

The Court: I do not conceive that it is. It certainly does not meet any evidence that has been presented on behalf of the plaintiff or the intervenor.

Mr. MacKinnon: It meets the question as to

(Testimony of James K. Polk.)

cross-examination with respect to the failure to notify from February 11 to April 2.

The Court: Yes, but that only goes to the manner in which this matter was handled, not with respect to any motive. I do not see that there is any question of motives involved in it at all. Anyhow, I think the question is generally [1369] objectionable on the ground stated, and I will sustain it.

Mr. Adams: I have no further questions of Mr. Polk.

The Court: Anything further, gentlemen?

Mr. Phleger: No.

Mr. Clark: Nothing from us, your Honor.

Mr. Adams: At this time, your Honor, I offer as Defendants' Exhibit 39 a memorandum identified as Interveners' Exhibit 232 upon the deposition, and I will ask counsel to look at that and agree with me, if we can, upon a statement in regard to it.

Will it be stipulated that this memorandum, which carries a pencil notation upon it, "November 22, 1944," is a memorandum that was made in New York at or prior to that time by Miss Valouch, and that the memorandum was produced from the tax files in New York that were examined upon the taking of the depositions?

Mr. Clark: And also, as the exhibit shows, that the memorandum was handed to Mr. Engelbright of the defendant company on November 22, 1944.

Mr. Adams: Yes, that may also be stipulated.

(Testimony of James K. Polk.)

May I have the stipulation of my statement? [1370]

Mr. Phleger: If that is the fact, all right. I think it is so short you might read it to the court.

Mr. Adams: I think I shall, but I want to get it authenticated right before I read it.

Mr. Clark: We will concede your statement.

Mr. Adams: The memorandum reads, your Honor:

“Approximate tax savings account worthlessness WPRR Company stock in 1943 (consolidated basis). 1942 carry-back \$4,000,000; 1943, \$8,000,000; 1944, carry-forward \$3,000,000.”

Underneath that in parentheses:

“Four months, total \$15,000,000.”

And the initials:

“M.C.V.”

All of that I have read so far being in typewriting, and then in the handwriting of Miss Valouch,

“Copy handed to Mr. Engelbright November 22, 1944.”

Mr. Engelbright is the assistant to the president identified by Mr. Elsey.

My particular purpose in offering this document at this time is in response to the showing with regard to the refund claim for 1942 which was filed five months after the date when this memorandum was made and filed in New York.

(Document referred to was thereupon received in evidence and marked Defendant's Exhibit 39.) [1371]

ROBERT E. COULSON

called as a witness on behalf of the defendant,
sworn.

The Clerk: State your name to the Court.

A. Robert E. Coulson.

Direct Examination

By Mr. Adams:

Q. Will you please state your business and your business address?

A. Lawyer, 40 Wall Street, New York.

Q. How long have you been engaged in the practice of the law? A. Something like 35 years.

Q. And you are a member of the firm of Whitman, Ransom, Coulson and Goetz, with its offices at that place? A. Yes.

Q. How long have you been a member of the firm? A. Slightly over 30 years.

Q. Have you specialized in any particular field of law?

A. No, I have been engaged in general business and corporate practice during the period.

Q. When did you first meet Mr. Arthur Curtiss James?

A. To the best of my recollection, in 1919. I can't fix it more closely.

Q. And in what connection? [1372]

A. He became a client of our office shortly after its organization.

Q. And was it in connection with the law work

(Testimony of Robert E. Coulson.)

being done in the office for Mr. James that you met him? A. Yes.

Q. And did you thereafter, yourself, engage in legal service for Mr. James? A. Yes.

Q. How long did you continue to represent him?

A. Until his death in 1941.

Q. Now, Mr. Coulson, did you participate in the Western Pacific reorganization proceedings?

A. Yes.

Q. In what capacity?

A. I was counsel for the A. C. James Company.

Q. And that was from the beginning of the proceedings?

A. Well, the A. C. James Company didn't intervene at the beginning of the proceeding, but it came in before the Interstate Commerce Commission, to the best of my recollection, some time in 1936. The petition was filed in '35.

Q. From the time——

A. May I complete my answer?

Q. Yes, pardon me.

A. (Continuing): And a claim was filed by the A. C. James Company in the bankruptcy court in San Francisco in the Northern District [1373] of California, Southern Division, shortly after the petition was filed in 1935.

Q. And from the time that the A. C. James Company became a party to the reorganization proceeding, did you represent it as a party in the reorganization proceedings? A. Yes.

(Testimony of Robert E. Coulson.)

Q. And continued to do so throughout the proceedings until they were concluded?

A. Subject to the qualification that I acted as a member of the reorganization committee from the fall of 1943 until the consummation of the reorganization at the end of '44.

Q. Well, now, in speaking of that, Mr. Coulson, you are speaking of an additional relation which you had to the reorganization, are you not?

A. There was no termination of the relation of the office as counsel for the A. C. James Company.

Q. Were you at any time a director of the plaintiff corporation, the Western Pacific Railroad Corporation? A. Yes.

Q. And during what period were you a director of that company?

A. To the best of my recollection, from about 1934 until about February, 1942.

Q. Now in February, 1942, you resigned and your resignation was accepted?

A. Yes. [1374]

Q. And was Mr. Carman's resignation as a director accepted about the same time?

A. At about the same time.

Q. Now to your knowledge did the James interests have any representation on the Board of Directors of plaintiff corporation after resignation of Mr. Carman and yourself? A. No.

Q. You have said you were a member of the reorganization committee?

(Testimony of Robert E. Coulson.)

A. That was a committee, your Honor, that was provided for in the plan of reorganization and constituted during the latter part of the preceedings.

Q. Who were the other members, Mr. Coulson?

A. Mr. Frederick H. Ecker was chairman of the Metropolitan Life Insurance; Mr. Frank C. Wright, Reconstruction Finance Corporation—their railroad expert was a member, and I was the third member.

Q. And who designated you for such membership?

A. The designation was a joint designation by the Railroad Credit Corporation and the A. C. James Company, which was as provided in the plan.

Q. And the committee selected your firm to be its counsel?

A. Yes.

Q. Now do you recall that your firm were retained as tax counsel by the reorganization trustees in the Western Pacific [1375] reorganization?

A. Yes.

Q. When were they retained?

A. Well, it occurred in the spring of 1943, and to the best of my recollection not very long after the Supreme Court decision of March 15, 1943.

Q. Were you in charge of that tax work?

A. No.

Q. Who was in charge of it?

A. Our partner, Mr. James K. Polk, who was in charge of the tax work in the office, the prior witness.

(Testimony of Robert E. Coulson.)

Q. Did you supervise Mr. Polk's activities in his work as a tax lawyer in this matter?

A. No.

Q. Did he keep you generally informed as to the work that he was doing? A. He did.

Q. Who decided what advice should be given in respect of tax matters involved in that work of your firm for the reorganization trustees?

A. Mr. Polk took the responsibility for the decision of the work being done by him and his associates in his department.

Q. Now who made the decision to recommend that consolidated federal tax returns be filed for 1942? A. Mr. Polk. [1376]

Mr. Phleger: Just a moment. If you know.

Q. (By Mr. Adams): Yes, if you know, surely.

A. I do know that Mr. Polk wrote a letter in the spring of 1943. I can't fix the date, but I saw the letter before it was sent.

Mr. Adams: Plaintiff's 50, please.

(Document produced by the clerk.)

Q. (By Mr. Adams): Mr. Polk, I show you Plaintiff's Exhibit 50, a letter dated May 20, 1943, (handing to witness), and I ask you if that is the letter to which you referred in your answer of a moment ago. A. Yes.

Mr. Phleger: I don't want to interrupt, but that is the May 20 letter?

Mr. Adams: Yes.

(Testimony of Robert E. Coulson.)

The Witness: The letter shown me is the letter of May 20, 1943, signed by James K. Polk and addressed to Mr. M. J. Curry, in the New York office at 37 Wall Street.

Mr. Phleger: I don't want to interrupt, but the returns had already been filed.

Mr. Adams: Well, I think that is an interruption and certainly has no reference whatever to the question I asked. The witness in his answer referred to a letter, and I produced the document to see if that is the letter he referred to.

Mr. Phleger: I am sorry. I just want to—I thought the [1377] question was who gave the advice about the filing of the consolidated returns for 1942, and he said Mr. Polk, and then he cites a letter written after the date.

Mr. Adams: Your Honor, I would like to proceed with my examination. It will be simpler.

The Court: All right.

Q. (By Mr. Adams): Mr. Coulson, when did you first learn of the possibility of using the stock loss in the federal tax return?

A. It was at or about the time of the letter of May 20, 1943, was written.

Q. Who informed you?

A. Mr. Polk discussed that matter, and it is referred to in the letter.

Q. And will you state to the best of your recollection the substance of your discussion with Mr. Polk about that at that time?

(Testimony of Robert E. Coulson.)

A. Mr. Polk told me that he felt that there was a substantial possibility of claiming a substantial loss on the part of the holding company because of the finding under the plan that the stock was worthless, and that when the plan was consummated, it would disappear as a worthless security. At the time I questioned whether, with an unlisted stock of that kind, he wouldn't have serious difficulty in establishing the year of loss. That is to the best of my recollection the conversation that occurred.

Mr. Adams: Now may I have Plaintiff's 50 once more, Mr.——

Q. You just looked at Plaintiff's 50, didn't you, Mr. Coulson?

A. If that is the letter of May 20, 1943. I didn't notice your notation on it.

Q. Yes. Now did you see Plaintiff's 50, the letter of May 20, 1943, before it was sent?

A. To the best of my recollection, I did.

Q. Now when, if you know, was the first time it was decided to recommend that the stock loss be used in a federal tax return?

A. It was either, so far as my own knowledge, it was either determined some time in December of '43 or January of '44, to recommend that to Mr. Elsey.

Q. And who, if you know, made the recommendation to Mr. Elsey? A. Mr. Polk.

Q. Did you have any discussion at or about that time of the book treatment to be afforded the federal tax accruals? A. Yes.

(Testimony of Robert E. Coulson.)

Q. And please state when, and with whom, as well as you can remember, and what the discussion was.

A. To the best of my recollection, I discussed with Mr. Polk, whether it was in New York or on telephone from San Francisco, I cannot remember, the question whether, if the returns for '43 were filed with the tax loss as a deduction, the amounts that had been accrued on the books, maintained by the agent for the trustees, the company's books here, should be reversed. And if [1379] so, what accounting treatment should be given of the possible liability, if the deductions were subsequently disallowed by the Treasury Department. Now I can't place the time of those discussions, except that it was in either December or January—December of '43 or January of 1944.

Q. To the best of your recollection, with whom did you have those discussions?

A. So far as I recollect, with Mr. Polk. There may have been discussions with Mr. Elsey, but I don't recollect them.

Q. Now did you participate in the decision to recommend the setting up of a contingent reserve fund for the federal taxes for the year 1943?

A. Yes.

Q. In what capacity did you participate in that discussion?

A. Mr. Elsey submitted to the reorganization committee, through me, his desire to put on the

(Testimony of Robert E. Coulson.)

books a reserve or a fund to protect possible liability if the Treasury Department denied that deduction. I took it up with Mr. Ecker and Mr. Wright, to the best of my recollection, and secured approval of Mr. Elsey's recommendation.

Q. When, if you recall, did you first learn of the type of federal tax returns which were to be recommended for the year 1944?

A. To the best of my recollection, it was late in the year 1944 that I first learned of it. I can't fix the time unless there is [1380] correspondence that shows.

Q. Who made the recommendation, if you recall?

A. It was Mr. Polk's determination to give that advice.

Q. Now when did you learn that a claim for refund of the taxes paid in 1942 had been or would be filed?

A. Again I cannot fix the time, but I think I learned of it at or about the time the claim for refund was filed.

Q. Now in the record here it appears that a stockholders' action which we call the "Van Kirk Action," was instituted in New York along at the end of June, 1946. When did you learn of the commencement of that litigation?

A. Shortly after it was started, because I was served as a defendant, with the company.

Q. Did you then believe that there was any con-

(Testimony of Robert E. Coulson.)

flict in your firm's representation of the affiliated group in the tax matter?

Mr. Phleger: Just a moment—well, I will withdraw that.

The Witness: I saw no conflict arising as a result of that litigation, no.

Q. And what is the basis of the answer you have just given?

Mr. Phleger: Now, I object to that on the ground it is incompetent, irrelevant and immaterial.

The Court: Well, you let him answer the question as to his belief. I suppose on the theory that that is a separate fact. Now you are asking to argue the matter and give his reasons why he felt that way about it. [1381]

Mr. Phleger: That is right.

Mr. Adams: That is a fair statement, your Honor.

The Court: Well, wouldn't that, of course, be subject to the orthodox objection that it is his opinion and conclusion?

Mr. Adams: Well, this is the party to the transaction; his firm were representing the trustees in the tax matter. There is some complaint about how the tax matters were handled in this case. I confess I don't get either the point or the significance of it; but I have heard some such complaint voiced. I have heard a generalization that this was taken over. I don't thoroughly understand what is meant by that. I am seeking to meet it, because that is

(Testimony of Robert E. Coulson.)

brought to us. This is a party to the transaction, your Honor, and I am asking about his action and about his understanding of his position at the time.

The Court: Well, you ask him to give his reasons for it. He can tell you almost anything he wants to as to that.

Mr. Adams: Well, I dare say we all expect answers from witnesses to be correct to the best of their ability.

The Court: Yes, but we are so often disappointed that we have these rules of evidence to prevent that.

I think the objection is good. I will sustain it. It just puzzled me a little bit why Mr. Phleger didn't object to the first one and did object to the second one.

Mr. Phleger: I just wanted to assist in the expedition of the case. I didn't think he would ask the second question. [1382]

Mr. Adams: I am very grateful to counsel for his cooperation.

Q. When did you first learn of the plaintiff's decision to bring this action now pending?

A. Mr. Polk told me about it at the time he had an exchange of correspondence, which I think was put in the record this morning, as to whether it would interfere with his tax work. And I think I had also been told by Mr. Osborn or Mr. Wood or Mr. Curry at or about that time, that it was proposed.

(Testimony of Robert E. Coulson.)

Q. Now you referred in your answer to correspondence that was put in this morning, and I will hand to you Defendant's Exhibit 37A, being a letter from the president of the corporation addressed to your firm, of September 27, 1946, and Defendant's 8A—no, 37B, being a letter from Mr. Curry to Mr. Nicodemus and Mr. Osborn of October 5, 1946, and 37C, being a copy of Mr. Polk's letter to Mr. Curry of October 4, 1946, the preceding day, and I will ask you if that is the correspondence and those are the letters to which you referred in your previous answer (handing to witness).

The Court: You are referring to Plaintiff's Exhibits or Defendant's Exhibits?

Mr. Adams: Defendant's, your Honor.

A. Well, the only letters I saw, Mr. Adams, were of course Plaintiff's Exhibit 8B and the exhibit, Defendant's Exhibit 37A, or Plaintiff's Exhibit 7, I guess it is here. I did not see Mr. [1383] Curry's letter to Mr. Nicodemus, and Mr. Osborn, which is 8A, Plaintiff's Exhibit 8A.

Q. I should not have shown it to you, obviously.

The Court: Now we have got the record all mixed up.

Mr. Adams: Yes, and so that the record may be all clear, because I have been confused and referring to some other marks instead of the ones here—the document Defendant's Exhibit 37A carries a deposition mark, Plaintiff's Exhibit 7. But

(Testimony of Robert E. Coulson.)

it is Defendant's Exhibit 37B—also marked Plaintiff's Exhibit 8A on deposition. And Defendant's 37C is also marked Plaintiff's 8B on deposition.

The Court: All right.

Q. (By Mr. Adams): Now referring to the time when you learned of plaintiff's decision to bring an action out here in San Francisco with regard to the tax matters here in issue, did you then believe that there was any conflict in the firm's representation of the affiliated group? A. No.

Mr. Phleger: Well, I will object to the question now upon the ground it calls for the conclusion of the witness, incompetent, irrelevant and immaterial.

The Court: Well, I think so. What have you got in mind there? He heard that they were going to be sued, and whether or not when he heard they were being sued, what was his belief as to whether the firm had acted in any improper manner? Is that [1384] involved?

Mr. Adams: No, the question is, your Honor, at that time the firm and Mr. Polk, the active man in charge, was handling these tax matters for this group before the government. This litigation came in New York, and the witness has said he personally was a defendant in it. He was a party to that litigation, in which were involved claims against the tax results of Mr. Polk's work, when, as, and if Mr. Polk's work should bring about tax results.

The Court: I understand that; but all you were asking him is what his belief was.

(Testimony of Robert E. Coulson.)

Mr. Adams: That is correct.

The Court: But he must have believed, giving him the benefit of all possible doubts, that we give everyone, he must have believed it was all right and then he went ahead and did it.

Mr. Adams: Precisely, your Honor. That is right.

The Court: What is the point of asking that of the witness then?

Mr. Adams: Well, I think we can assume that would be the answer, but that is the answer I expected from the question I asked.

Your Honor has ruled? I wasn't quite sure of it.

The Court: Well, I don't see the competency of it. I will sustain the objection. I know he is not going to say "No." He is not going to give the wrong answer, so don't worry about it. [1385]

Mr. Adams: Well, let me say this: I am sure that both the witness and his counsel will very firmly persist in the view that there was no conflict and that what was done was right. But that is a matter of argument.

The Court: I think so.

Q. (By Mr. Adams): Now, Mr. Coulson, did any representative of the plaintiff corporation inform you that he believed there was any conflict between the tax work that was being done for the affiliated group by your firm and Mr. Polk in particular, and your relations to the litigation, either in New York or here in San Francisco, in which

(Testimony of Robert E. Coulson.)

there were conflicting claims about the tax savings?

Mr. Clark: I object to that, your Honor, on the ground it is incompetent, irrelevant and immaterial. That is one of the allegations or burdens of the New York action, in which this gentleman was named as a defendant, part by the minority stockholders on behalf of the corporation.

The Court: Well, I think in this question it is pretty long, but in the beginning it started out with asking if anyone had made any on behalf of the corporation, had pointed that out to him; isn't that right?

Mr. Adams: That is right.

The Court: I think that may be proper. Overruled.

A. No one did.

Q. (By Mr. Adams): Now when did you first learn of the filing [1386] of the complaint in intervention in this litigation here in San Francisco before his Honor?

A. I can't fix the time, but to the best of my recollection, I learned of the complaint in intervention shortly after it was filed. [1386A]

Mr. Levy: Mr. Adams, Mr. Coulson's affidavit in opposition is dated March 21, 1946, if that would help you.

Mr. Clark: And it is in this record.

Mr. Adams: The record undoubtedly will show those dates.

Q. Had you any discussion with anyone con-

(Testimony of Robert E. Coulson.)

cerning settlement of the tax claim with the Treasury Department prior to February 11, 1947?

A. No.

Q. When did you first learn of the proposal of settlement?

A. When Mr. Polk called up from Washington when I was here in San Francisco, which to the best of my recollection was February 11.

Q. You recall the occasion?

A. I recall the occasion.

Q. Would you tell his Honor briefly the conversation that Mr. Polk had with you on that subject.

A. Mr. Polk called up from Washington and said that he had a discussion, a formal hearing before the Treasury Department officials there, that it looked as if the alternative was either to try out the issue of worthlessness before the tax court and the courts or to have some settlement of those issues satisfactory to the Government and to the taxpayer. He asked me to go to Mr. Elsey's office and discuss the matter with Mr. Elsey and advise him whether Mr. Elsey and his company would approve an offer of settlement to be submitted then [1387] on an informal basis, which would involve accepting the returns as filed, which meant an agreement by implication if the thing went through to give up any claim for refund as to 1942.

I did go to Mr. Elsey's office. Mr. Elsey did communicate with all the directors that could be

(Testimony of Robert E. Coulson.)

reached, except one that was away, or maybe two, and Mr. Polk was advised from Mr. Elsey's office that he was authorized to submit the settlement and a telegram and letter was sent to him at that time, as I recollect.

Q. Was anything said at that time about notifying or not notifying the plaintiff corporation?

A. I have no recollection of anyone mentioning it at that time.

Q. Did you ever at any time tell Mr. Polk that he was not to notify the plaintiff of the proposal of settlement? A. No.

Q. Mr. Coulson, do you recall that Mr. Curry was retained by your firm at the time of the closing of the New York office of the corporation and the trustees—actually then of the reorganized railroad company—along early in 1945?

A. Well, it was at or about the closing of the New York office.

Q. Mr. Coulson, I show you Plaintiff's Exhibit 32-A in this case. This is your signature, is it not?

A. It looks like a photostat of a letter which I signed, judging from the signature. May I look at the letter? This [1388] letter of April 21, 1945, addressed to Mr. Charles Elsey, was a letter which I recollect writing and signing at about that time.

Q. Prior to that time, Mr. Coulson, had you discussed the proposed retainer of Mr. Curry with anyone, to the best of your recollection?

A. Yes.

(Testimony of Robert E. Coulson.)

Q. With whom had you discussed the matter?

A. To the best of my recollection it was the subject matter of several discussions with Mr. Schumacher, Thomas M. Schumacher, who had been the chief executive in the New York office for many years. It was also, as I recollect, discussed with Mr. Osborn more briefly. It was discussed with Mr. Curry, and I think also with Mr. Nicodemus.

Q. And as regards Mr. Nicodemus, is your recollection clear one way or the other?

A. I am not sure. I recollect quite clearly and definitely the discussions with Mr. Schumacher and with Mr. Curry, because those discussions covered not only Mr. Curry's retainer but the other members of the staff in the New York office. Those I am quite clear on. And they were extended. I am quite clear I had some discussions with Mr. Osborn and I think some with Mr. Nicodemus, but I can't be positive as to that.

Q. Referring to the discussions on the subject of Mr. Curry's prospective retainer, will you please state to the best of your [1389] recollection the substance of the discussions you had on that subject before the retainer was effected?

A. Mr. Schumacher had discussed the problem at some length on the basis of the application of the company's retirement plan, not giving Mr. Curry a pension, which bore, as Mr. Schumacher saw it, a reasonable relation to the salary which Mr. Curry had been receiving as an executive in the New York office.

(Testimony of Robert E. Coulson.)

I want to add one more to the people I discussed it with, because before I wrote that letter to Mr. Elsey which you showed me, I took up the matter by telephone with Mr. Polk, who was away from New York, as to whether the suggestion that had been made in my talks, that Mr. Curry would be useful in connection with the consolidated return, was in his judgment well founded. Mr. Polk told me on the telephone, as I recollect it, that he thought Mr. Curry's usefulness would be substantial if these consolidated years of 1942, 1943 and 1944 came to trial, especially on depreciation matters and historical matters as to earlier years. It was on that basis that I then wrote Mr. Elsey suggesting that he be put on the stand by retainer in an amount about equal to the pension he would get from the operating company, and which brought his total overall compensation for the period while the tax matter was in process up somewhat more closely to his prior salary as an executive in the New York office [1390]

Q. Was there some discussion at or about the same time with regard to the other employees who had been in the New York office?

A. They were all discussed, both with Mr. Schumacher and with Mr. Curry.

Q. Please state to the Court briefly about that discussion and what was done as respects such employees.

(Testimony of Robert E. Coulson.)

A. Well, the employees in the New York office, other than Mr. Schumacher and Mr. Curry, who were the executives, and who were under the pension plan, were given by the railroad company a separation allowance of, to the best of my recollection, six months' salary. Some of them did not want immediate employment for one reason or another. There were two who wanted to go on working, and those two were employed by our office at that time and were referred to in that letter you showed me which I wrote to Mr. Elsey, although they were not a problem of the operating company except in the sense that the operating company was interested in knowing what happened to the New York employees after the closing of the office.

Q. And two of those employees came over to your office and you took them in?

A. Miss Valouch and Miss O'Neill came, and they are both still there.

Q. What services did you tell Mr. Curry he was to perform for his retainer when you made that arrangement with him? [1391]

A. I explained what we had in mind, that he would be available to assist Mr. Polk and would probably be used as a witness if those cases came to trial, and meanwhile he was to have a standby attitude of helpfulness to Mr. Polk in the preparation of material to assert the claims in the Treasury Department.

Q. I show you Plaintiff's Exhibit 33, being

(Testimony of Robert E. Coulson.)

a letter addressed to Mr. Curry of June 6, 1945, and ask whether that is the letter which you sent to Mr. Curry at that date stating the terms and outlining the services in respect to his retainer.

A. This letter accompanied the first quarterly payment of his retainer. It was not intended to outline his services which had been covered in conversations. It merely stated to him that the check was transmitted and that he was in the status of an independent contractor, so no deductions were being made for Social Security taxes or other deductions which would have been made had he been an employee of our office in the strict sense.

Q. How many times did you see Mr. Curry after he was retained by your firm?

A. I can't fix the number of times. It was not very often.

Q. Did you give him any instructions as to what he should or should not do?

A. Only the initial request that he put himself at Mr. Polk's disposal in connection with the consolidated return.

Q. Prior to the commencement of the VanKirk litigation in [1392] New York had you ever heard of a claim with respect to taxes in the nature of the claim set forth by the plaintiffs in that lawsuit?

Mr. Phleger: I object to that question on the ground it calls for the conclusion of the witness, irrelevant, incompetent and immaterial.

The Court: I suppose Mr. Adams means prior

(Testimony of Robert E. Coulson.)

to that time had anyone asserted that claim to his knowledge.

Mr. Phleger: That is not the question.

Mr. Adams: I did ask, your Honor, if the witness had ever heard of any such claim.

The Court: You mean any such claim being made against whom?

Mr. Adams: Any claim like this one.

Mr. Clark: Against anybody.

Mr. Adams: That is right. I did ask that question.

Mr. Clark: We join in the objection.

Mr. Adams: I have stated in argument from time to time that one of our contentions is that this is an afterthought claim, and this is the same sort of question that I have asked prior witnesses.

The Court: I think what counsel is bothered about, is this the same kind of question that you asked Mr. Polk?

Mr. Adams: I do not think it is, your Honor.

The Court: You are referring to the claim against the [1393] defendant in this case, are you not?

Mr. Adams: No, not at all. I am asking this witness, just as I asked Mr. Ehrman, Mr. Elsey and Mr. Osborn, if they had ever heard of a claim to be paid for the tax benefit of your loss when you are a loss company in a consolidated return. I did ask all those gentlemen that question, in view of my argument that this is an afterthought.

(Testimony of Robert E. Coulson.)

Mr. Clark: It is the same question that has been ruled on, your Honor.

The Court: I think it is objectionable. I do not see that it has anything to do with the question of its being an afterthought.

Mr. Adams: Do I understand that the objection is sustained?

The Court: Yes.

Q. (By Mr. Adams): Prior to the commencement of the Van Kirk action, Mr. Coulson, had you ever heard of the claim there asserted in behalf of the plaintiff corporation?

Mr. Phleger: I submit that has been asked and answered.

Mr. Adams: I would like to ask it again.

The Court: Read the question.

(Question read.)

The Court: You said that was the first time you had heard about it.

The Witness: No one had suggested it before, I think my [1394] prior testimony was, Judge. I can't bring it back word for word.

Q. (By Mr. Adams): Prior to the Van Kirk action had it ever occurred to you that the plaintiff had any such claim as was asserted in its behalf in the Van Kirk lawsuit?

A. Definitely——

Mr. Phleger: I submit the same objection that was made to substantially the same question some time ago. It is incompetent, irrelevant and im-

(Testimony of Robert E. Coulson.)

material and calls for the conclusion of the witness.

The Court: Sustained.

Mr. Clark: May the answer go out?

The Court: Yes.

Mr. Adams: I have no further questions, your Honor.

Mr. Phleger: I have no questions.

Mr. Clark: Nothing from us.

* * *

JAMES L. COCKBURN, JR.

called on behalf of the defendants; sworn.

The Clerk: Will you state your name to the Court, please.

The Witness: My name is James L. Cockburn, C-o-c-k-b-u-r-n, Jr. [1395]

Direct Examination

By Mr. Adams:

Q. And, Mr. Cockburn, will you please state your business and your business address.

A. I am with Price, Waterhouse & Company, certified public accountants, at 351 California Street, San Francisco.

Q. And you are forty-five years of age?

A. That is correct.

Q. You came to the United States in 1922 from Scotland and became a citizen in 1930?

A. That is correct.

Q. And your profession is?

(Testimony of James L. Cockburn, Jr.)

A. Certified public accountant.

Q. Please state briefly your education.

A. I went to primary and high school in Edinburgh Royal High School, in Edinburgh, Scotland. I was one year at the Heriot-Watt College in Edinburgh, an engineering course, and after coming to this country, in Honolulu, I attended classes in the evenings at the University of Hawaii, and the YMCA in accounting courses, and upon coming to San Francisco in 1926, I continued with my studies, including evening courses at Pace & Pace, San Francisco. This led to my sitting in an examination and getting my certified public accountant certificate in 1930, in California.

Q. Now, will you state briefly what professional experience you have had? [1396]

A. Well, I have been in public accounting, accounting and tax work, for approximately twenty-five years, starting with Young, Lamberton & Pearson in Honolulu in 1923, Price and Waterhouse from 1926 to the present time, except for a period of about three years, of which two and a half were spent as an assistant to the Comptroller of the California Packing Corporation in San Francisco and a few months in independent practice.

Q. Now, from about 1934, what part of your work would you say had been, had had to do, primarily, with tax work?

A. From 1934 on to 1943, I worked almost entirely in the tax department of Price, Waterhouse

(Testimony of James L. Cockburn, Jr.)

and I was in charge of the tax department from 1937 to 1943.

Q. And since that time have you continued to engage largely in tax work?

A. Both tax work and regular auditing work.

Q. Are you at the present time a member of the faculty of the Golden Gate College in San Francisco?

A. I am.

Q. And what course are you giving there?

A. Auditing of revenue accounts.

Q. Auditing of revenue accounts. And you were admitted to practice before the United States Treasury Department in 1935?

A. That is correct. [1397]

Q. And you were admitted in the same year to practice before the United States Board of Tax Appeals, now the United States Tax Court?

A. I was.

Q. Of what professional—rather, let me put it this way: Would you please state briefly your activities, if any, in professional societies.

A. Well, I am a member of the American Institute of Accountants; I became a member of that organization in 1936. I have been a member of the California Society of Certified Public Accountants since 1930. I was a member of the Committee on Taxation of the State Society at various times, and was chairman about 1945-46 here. I was president of the San Francisco chapter of the California Society in 1947, and I have been a member of various committees in the society and chapter.

Mr. Adams: Now, at this time, your Honor, I

(Testimony of James L. Cockburn, Jr.)

would ask to have marked for identification as Defendants' Exhibit 40 a printed report entitled "The Western Pacific Railroad Corporation and Subsidiaries' Report on Federal Income Taxes Paid for the Years 1918 to 1944 and Settlements Amongst Companies in Respect Thereto," over the name of Price & Waterhouse Company, 351 California Street, San Francisco 4.

(The report referred to was marked Defendants' Exhibit 40 for Identification.)

Mr. Adams: And if I may take the liberty, I will hand up [1398] a copy to his Honor and state that copies of this report were furnished to counsel sometime prior to the pre-trial.

(Document handed to Court.)

Q. (By Mr. Adams): Now, Mr. Cockburn, did our firm request you to make an examination of the files and records of the Western Pacific Railroad Corporation and its affiliated companies for the period beginning in 1916 and ending April 30, 1944? A. It did.

Q. And would you state, please, the objectives of the examination which was requested?

A. We were asked to undertake three things: One, to determine the Federal and excess profits taxes paid by the Western Pacific Railroad Corporation and its subsidiaries for the period 1916 to 1944; secondly, we were asked to determine the settlements that were made between companies

(Testimony of James L. Cockburn, Jr.)

within the group, within the affiliated group, with respect to the Federal taxes on income; and, thirdly, we were asked to determine whether any company included in the consolidated return having a net income made a payment to a company with a net loss by reason of the fact that that net loss was included in the consolidated return.

Q. And did you make such an examination?

A. I did.

Q. Who made it?

A. It was made by me, assisted by several individuals in our [1399] San Francisco and New York office.

Q. And the assistants of whom you speak proceed with their work under your supervision and direction? A. That is correct.

Q. Would you please identify the persons who assisted you in your examination.

A. Mr. Richard Brown, Mr. Harold Erb, Mr. Frank Turk, and my principal assistant was Mr. Edwin H. Morse of San Francisco. Mr. Turk and Mr. Erb are in our New York offices.

Q. And would you also state what relation, if any, Mr. Morse has had to Price, Waterhouse & Company?

A. Mr. Morse has been with Price, Waterhouse & Company since 1939, except that he was originally with our New York office, and has been with us since that time except for a period of time in the armed services, with the Department of Audits, Washington.

(Testimony of James L. Cockburn, Jr.)

Q. And with which office of Price, Waterhouse & Company is Mr. Brown connected?

A. San Francisco.

Q. Was all the work in this examination done by you or under your personal direction?

A. It was.

Q. About how long a period of time was occupied in your work of examination and the completion of your report?

A. We commenced the work in May, 1948, and completed it early in January, 1949. [1400]

Q. Has your report been delivered to the Western Pacific Railroad Company? A. It has.

Q. Now, I hand you, Mr. Cockburn, the report now marked Defendants' Exhibit 40 for Identification (handing to witness). Is that a copy of the report? A. It is.

Q. Will you please describe briefly the records which you examined?

A. We first visited the office of the Western Pacific Railroad Company in San Francisco and there examined copies of Federal income tax and excess profits tax returns, Revenue Agents' reports and other material in the Federal income tax files. We examined the general books of account, including the general ledger, cash book, general journal, voucher register. We also inspected canceled checks and correspondence.

Q. And in addition to that, did you do some work with respect to the Western Realty Company records or accounts?

(Testimony of James L. Cockburn, Jr.)

A. We inspected similar records of the Western Realty Company at its office in San Francisco.

Q. Did you do any of your examination in New York? A. Yes.

Q. What did you do there?

A. We proceeded to New York and examined there similar records of the Western Pacific Railroad Corporation, and also their [1401] corporate minutes.

Q. Now, did you obtain any additional information from other sources beyond what you have already described? A. Yes.

Q. What was that?

A. We obtained additional information from the Treasury Department at Washington, D. C., consisting of certificates of over-assessment relating to certain years, and we also obtained certain additional information from the Utah Fuel Company.

Q. And where did you get that information?

A. At Salt Lake City.

Q. Now, Mr. Cockburn, what procedure did you follow in determining your findings?

A. Well, we made an analysis of the accounts relating to the tax expenses and receivable and payable accounts. With respect also to all of the companies in the Western Pacific group.

Q. And are your findings summarized in your report? A. They are.

Q. Now, in what manner, if at all, did you check your findings?

(Testimony of James L. Cockburn, Jr.)

A. We were able to check the taxes paid according to the expense accounts with the tax returns, Revenue Agents' reports and similar data. We were also able to check the tax paid by the various companies against the surplus reconciliation appearing in the tax return. Thirdly, we were able to cross-check the payments made between companies as between the books [1402] of the inter-company transactions and in particular letters concerning the transactions between the San Francisco and New York offices.

Q. So that you did in fact check entries both in San Francisco and corresponding entries and records in New York?

A. That is correct.

Q. In making such cross-checks did you find any discrepancies?

A. We did not.

Q. Are your findings with regard to the subject matter of your examination correctly summarized in your printed report?

A. They are.

Q. Does your printed report correctly summarize the information contained in the tax records of the respective corporations for the period and on the subjects covered by your report?

A. It does.

Q. Do you believe it to be correct?

A. I do.

Q. Now, Mr. Cockburn, I will ask you to explain to the Court the schedules and tabulations it contains. Will you please first take Schedule 1.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: May it please the Court, I think this is probably an appropriate time to interpose an objection to the admissibility of this identified exhibit and the material which it contains. The objection is that it is incompetent, irrelevant [1403] and immaterial. I think we have argued and discussed this matter at length heretofore. It is our position that what was done in the years previous to the critical years under different circumstances and under different law is no evidence in the case.

Mr. Clark: In addition to that, your Honor, so far as this document is concerned, it also contains conclusions as to matters of fact which are not subject to expert testimony, such as a statement in the first page to the effect that it was the consistent practice of the Western Pacific group to do this and that. It is also based upon certain assertions of fact which should properly be elicited by oral testimony. We will add to our objection that this is not a proper method of developing any expert opinion this gentleman may have.

Mr. Phleger: Our objection hasn't anything to do with that. Our objection is it is just incompetent, irrelevant and immaterial because the circumstances which existed during this entire period were entirely different from those which existed in these critical years, and the law was different.

Mr. Adams: May I respond to plaintiff's objection, because I think the interveners' objections are premature, the report not yet having been offered.

(Testimony of James L. Cockburn, Jr.)

Mr. Clark: We are simply adding them at this time to plaintiff's objection, in which we concur.

Mr. Adams: The objections are wholly premature as stated [1404] by the intervener since I have not offered the report. The objections may run to the report when it is offered, but plaintiff's objection runs to the whole subject matter of this report and should, I think, fairly be answered at this time.

Your Honor, this is our defense. You will recall we had some discussion of this when Mr. Elsey was on the stand. One of our defenses is this, that during the whole period of affiliation between the plaintiff corporation and the defendant railroad company and other companies in that group, which began in 1916, and which ended for tax purposes on April 30, 1944, a consistent procedure was followed in the allocation of taxes, and that consistent procedure was that taxes should be allocated to the income-producing members of the group, and that no payment should be made to the loss company for the tax advantage which its loss brought to the affiliated group. That is our defense, your Honor, offered on our theory of the defense, on the particular facts in this case. We contend that that procedure, which this report is offered to establish, is binding upon the plaintiff corporation, being the party responsible and which established it. We contend further that it establishes a practice or contract relationship which will govern the determination of this case.

(Testimony of James L. Cockburn, Jr.)

We say further—and this is an additional reason for bringing forward this evidence—that when the plaintiff corporation comes into equity, and having enjoyed the advantages [1405] of an arrangement under which it secured the tax advantages of the losses of other companies and did not pay for them, it does not come into equity on the basis that equity can respond to, because of the ordinary rule that one who has had the fat off an arrangement between interlocking companies cannot then, when the thing turned out to be advantageous to someone else at the end of the period, insist upon taking a different position than that which he himself established and enforced during the time the arrangement was advantageous to him. These are theories. We have argued them before. And, as I say, this is our defense that we are putting in, and I take it your Honor can, of course, receive the evidence and consider its materiality in relation to any judgment your Honor may pronounce, but it would be inappropriate to exclude at this time evidence going to show the facts that are stated in the report. [1406]

The Court: I suppose there is really no dispute as to the fact because it all appears from the income tax returns and books that this was what was done, that is, what is shown in the report was done?

Mr. Adams: I think that is correct. This has been a very thorough and very arduous job to get the facts. We have had Mr. Cockburn and his associates, those who assisted him in his determination, spending months in getting the facts and

(Testimony of James L. Cockburn, Jr.)

getting them on a basis so that we think we have given a full, complete and correct account with respect to this matter for over all these years.

The Court: Of course, the only ultimate fact that is of any consequence is that each year the taxes were allocated as described in the report, and no credit or allowance was made to a company which suffered a loss in the group, or having contributed that loss, as it were, for the benefit of the final tax liability of the parent company or the group as a whole. I suppose there is no doubt about that.

Mr. Clark: Yes, there is, your Honor.

Mr. Adams: There are details provided in the report. If it is in, then counsel can use it. I rather assume that there is not going to be much question about the complete accuracy of the report. Then all counsel will have it to use as a basis of arguments, but we feel it is incumbent upon us—and we pleaded this in our pleadings—and we think it is a matter of defense [1407] that this was the continuous, standard practice that was followed throughout these years during all the time that the plaintiff corporation was the controlling party.

The Court: I would be inclined to think that as between the same parties to a transaction, that might be a persuasive argument. But, of course, you have the legal question here of whether this re-organized company can have the benefit of that. That, I think, would be one of the important questions that you have to present.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: I understand that is the plaintiff's theory of the case. We have a view that where the plaintiff starts during the period when it is in command and control and takes advantages out of the arrangement which it establishes, and then when, at the end of a tax period an advantage comes to another member of the affiliated group, the plaintiff should not be heard to complaint of the advantage of the other member if under its own practice established by itself it took the advantage in prior years and neither recognized any claim nor heard any complaint from any other member of the group that the plaintiff was doing what the plaintiff now complains of here.

The Court: I think those are matters that you will have to argue on the submission of the case. I still think the main question in this case is the question of the right, if any, in the plaintiff and the admeasurement of that right. There is no conflict that the reorganized company got the benefit of this. [1408] It may be that you can show that the plaintiff had no right or had no right that is capable of monetary measurement. I do not know. That is the real question in the case. I do not think any of these other matters make any difference.

Mr. Adams: We offer it as a part of our defense, your Honor, and you will appreciate it if I were to take a very simple situation—let us say you and I have been engaged in some kind of a common enterprise, and at the beginning of the term the arrangement between us has been very satisfactory

(Testimony of James L. Cockburn, Jr.)

to me. I do not think then at the end of the term, because it turns out to be very satisfactory to you, that I am in a position to complain about that.

The Court: As I say, if it is the same parties, of course, there might be a good argument, but your opponents contend that some new owners here got the benefit of this and they still think they have a right to get some salvage out of it because these other fellows got a benefit. I do not know if they have such a right. My mind is open on that, or whether it is capable of admission. That is a problem you gentlemen will have to labor under.

Mr. Adams: I am just seeking to put in my defense so I will have my facts, so that when the time comes for argument we will have them to argue from.

The Court: I merely suggested, counsel, that there is not much point in spending a lot of time arguing about the [1409] admissibility of this at this time. Why not let the witness testify that everything in this report is correct, and if you are not satisfied with his statement in that regard, you can cross-examine him on that. If you do not wish to cross-examine him, let the record be admitted in evidence and the question whether it has a legal bearing upon the issues of this case you can argue at the time of the submission of the case.

Mr. Phleger: We think we should interpose our objection so as to preserve our position. Counsel, I am sure, inadvertently, misstates the situation.

(Testimony of James L. Cockburn, Jr.)

We were the parent company during this period, and as the tax laws contemplated and intended, of course, we got the benefit. That did not require allocation of losses back and forth at all, but when we became a complete stranger, with no further financial stock in the situation, why, what took place in prior years is utterly immaterial.

The Court: I understand the position of the parties in the matter, but the defendant wants to assert a defense which he says he cannot present unless he has some record to present it on, because if he just says he is presenting it on the basis of the past conduct of the parties, he hasn't anything in the record to show what that was. He has no factual basis upon which to predicate that defense, and I think it probably would be a waste of time now to argue this thing out, because when you get all through I think I would take refuge in the rule of civil procedure which would allow me to reserve ruling on it, because I would want to [1410] consider it. I would want to have the benefit of the arguments of both sides on it, and I think the most sensible thing to do, and which would save time for everyone concerned, so that the whole question could be presented with its various facets at one time, would be simply to make your pro forma showing and have the witness testify that everything in that report is true and correct as a result of his investigations, and I will admit it in evidence subject to the future determination upon the sub-

(Testimony of James L. Cockburn, Jr.)

mission of the case as to whether or not it has a material bearing and does sustain the legal defense which is urged, and then you can argue that out at the time of the submission of the case. It certainly is unnecessary for me to sit here and listen to this witness go into each schedule and tell how he did it, if you are not going to raise any question about that.

Is that procedure generally agreeable to all counsel?

Mr. Phleger: That is entirely satisfactory.

Mr. Adams: I will ask the question asked by your Honor:

Q. Based upon the examination you have described, does your credit report correctly summarize the information contained in the books and records of the respective corporations for the period and on the subject covered by the report?

A. It does.

Q. And you believe it to be in all respects true and correct to the best of your capacity?

A. I do. [1411]

Mr. Adams: I will offer Defendant's Exhibit 40 for identification now as Defendant's Exhibit 40 in evidence.

Mr. Clark: To which we object, your Honor, on the ground stated by Mr. Phleger for the record, and also we specifically object to the inclusion of the first two pages, that is, the narrative on the first two pages of the offer as being conclusions on factual matters which should not be considered

(Testimony of James L. Cockburn, Jr.)

as evidence in the case. Other than that we have no objection to the suggestion of the court as to how they should be treated.

The Court: I won't give any weight to the opinion of the witness in that regard, inasmuch as it is a factual report. And I will admit it subject to the conditions which the court has already stated. However, if after examining the report either the plaintiff or the intervener wishes to conduct any cross-examination of the witness in respect to the accuracy of any statement, that right should be reserved to both the plaintiff and the intervener.

Mr. Clark: Very well, your Honor.

Mr. Adams: The record will show, your Honor, that counsel for all the parties have had copies of this report since some time prior to the pre-trial in this case.

Mr. Phleger: That is right.

Mr. Clark: That is right. [1412]

* * *

(The Defendant's Exhibit No. 40 for identification was thereupon received in evidence.)

Mr. Adams: If the Court please, I ask that there be marked for identification as Defendant's Exhibit 41 for identification a single sheet dated February 16, 1949, entitled "The Western Pacific Railroad Company, Federal Income and Excess Profits Taxes for Years 1942 and 1943 and for the First Four Months of 1944," on the basis of assuming that the Western Pacific Railroad Company had filed sepa-

(Testimony of James L. Cockburn, Jr.)

rate returns and had the benefit of its own net operating loss carry-overs and excess profits credit carry-overs computed as though it had filed separate returns in prior years, and the additional deductions from income as shown in the note below, and ask that the document be marked for identification Defendant's 41. And if I may take the liberty, I will hand up a copy to the Court, copy having been furnished this day to opposing counsel.

The Court: This would be similiar, then, to Plaintiff's Exhibit 73?

Mr. Adams: Basis 2. [1413]

The Court: Is that Basis 2?

Mr. Adams: Yes, Basis 2. It is more or less similar to Basis 2, but there is quite a wide difference, your Honor.

The Court: I mean you are attempting to show the same general thing?

Mr. Adams: I will ask the witness about that.

The Court: Very well.

Q. (By Mr. Adams): Mr. Cockburn, I hand you Defendant's Exhibit 41 for identification. Is that paper a summary of computations which you made?

A. It is.

Q. Where did you obtain the basic information from which your computations were made?

A. From the tax returns filed.

Q. And the tax returns for what years?

A. For the years 1939 to 1944, inclusive.

Mr. Adams: Now may the record show that the

(Testimony of James L. Cockburn, Jr.)

returns for 1940 to '45 have already been offered by the plaintiff?

Q. And do you have a copy of the 1939 tax return here? A. Yes.

Q. May I refer to that?

Mr. Adams: I will ask that Mr. Morse hand it up.

Mr. Phleger: The return for 1945 is not in evidence and we would like to have it in evidence, and also that for '46 and '47. [1414]

Mr. Adams: Well, my recollection was that Mr. Buchanan testified with regard to the basis of his computations, that he had used the returns from 1940 to 1946. Am I correct in that?

Mr. Phleger: Mr. Buchanan?

Mr. Clark: No, it is not.

Mr. Phleger: 1944.

Mr. Clark: In the last eight months, I think he said, of '44.

Q. (By Mr. Adams): Oh, that is in, yes. Well, your Honor, I don't have the returns for '46 and '47 with me, but with counsel's permission, I may proceed with the examination on the calculations, and we can produce the basic returns when we resume at the next session, if that is agreeable.

I do, at this time, offer as Defendant's Exhibit 42, the corporation income and excess profits tax return of the Western Pacific Railroad Corporation for the year 1939.

The Court: Well, why do you need that in connection with this?

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: The witness testified he had to go back to the figures in that return in order to get his computations.

The Court: For Exhibit 41?

Mr. Adams: Yes, your Honor.

The Court: I see.

The Clerk: Are you offering that in evidence?

Mr. Adams: Yes. And may I state I am producing this from [1415] the files of the defendant railroad company, being a copy sent by the plaintiff corporation to the defendant railroad company of the consolidated returns for 1939.

(Whereupon income tax return for 1939 was received in evidence and marked Defendant's Exhibit 42.)

Q. (By Mr. Adams): Now, Mr. Cockburn, referring to Defendant's 41 for identification, the schedule in your hands, did you make any correction in the information appearing on the income tax returns you have described in making the computations on this schedule?

A. Yes, I have made two principal corrections: one, the information from which these corrections were made appears in revenue agent's report dated June 12, 1947, relating to an examination of 1940 and 1941 consolidated federal income tax returns. The first adjustment related to a loss claimed on abandonment of Deep Creek properties, and the second related to an amount of reorganization expense of \$169,000, that was disallowed.

(Testimony of James L. Cockburn, Jr.)

Q. Now his Honor inquired how it came about that the income tax return for 1939 was related in any way to these computations. Did that arise in connection with the Deep Creek loss?

A. Part of it, yes.

Q. Well, please tell his Honor that part, and the other part as well.

Q. The Deep Creek loss was originally reported in 1940 federal [1416] income tax return. The revenue agent in his report explained that it was a 1939 item, and we therefore repositioned the loss to 1939; and as a result of a difference in the law, the item, the greater portion of the item, or \$600,000 for which the loss was claimed in 1940, was considered to be a capital loss, and since the company had already availed itself of a \$2,000 capital loss reduction, no benefit was obtained by repositioning the loss into that year. The balance of the adjustment of reorganization expense was just not claimed as a deduction in 1940.

Q. Go right ahead. I didn't want to interrupt you.

A. To explain further, the reason it was necessary to take into consideration the 1939 figures, the 1939 loss is a carry-over into the year 1941, for a net operating loss deduction, and in turn, that affects the excess profits credit carry-over into subsequent years.

Q. Was the consequence of this correction which you made to increase or to decrease the tax liability computations on 41 for identification?

(Testimony of James L. Cockburn, Jr.)

A. It increased the computation, the tax.

Q. Now in your computations, Defendant's 41 for identification, what treatment did you give inter-company interest accruals?

A. We treated that interest as a deduction.

Q. Had those inter-company interest accruals been eliminated in computing the consolidated return tax liability? [1417]

A. They had.

Q. Is it your understanding that they may be properly restored as deductions in computing income on a separate return basis?

A. It is.

Q. And do you have an understanding with respect to the recognition of such interest accruals where they have occurred during reorganization proceedings?

A. Yes, and the Commissioner has ruled on that.

Q. To what ruling do you refer?

A. I believe it is X.T. 3635.

Q. Now in the consolidated returns which were actually filed, were deductions taken for accruals of interest on all Western Pacific Railroad obligations that were held outside the affiliated group?

A. They were.

Q. Is it your understanding that such interest is deductible, even though not taken up as income in the accounts or tax returns of the creditors?

A. It is.

Q. Did you make any deductions not appearing on the consolidated returns as filed in the computations in your exhibit 41 for identification?

A. I did.

(Testimony of James L. Cockburn, Jr.)

Q. Will you please state what they were?

A. We made deductions for accelerated amortization in the years [1418] 1942, in the amount of \$127,531.24; in 1943, in the amount of \$259,654.81; in the first four months of 1944, in the amount of \$522,741.10. I also made deductions for the United States Government freight cut-backs and refunds in 1941 of \$50,000; in 1942, \$780,000; in 1943, \$1,060,000; the first four months of 1944, \$40,000. I also made a deduction for a partial bad debt loss on the Sacramento Northern Railway notes and advances in 1943, in the amount of \$8,526,690.72.

Q. Now, Mr. Cockburn, referring to the amounts you have stated, of deductions on account of accelerated amortization, will you please state the basis of deductions taken for accelerated amortization?

The Court: Well, the witness has answered that question. May I make this inquiry, so I can get myself a little bit oriented to this? I may be in error in this, but is the difference a substantial difference between Mr. Buchanan's basis and this estimate, the items that are listed at the bottom of the page of this Exhibit 41? I mean, a big, substantial difference?

Mr. Adams: Your Honor, your Honor's inquiry is based on, of course, at first, the proposition that the deductions that are taken in the lower half of this exhibit were not taken in Mr. Buchanan's Basis 2.

(Testimony of James L. Cockburn, Jr.)

The Court: Well, of course. I say that is the reason why this basis in Exhibit 41 is so much lower than that which this witness has included, or in which this witness has included, the [1419] substantial items that Mr. Buchanan did not use in his basis. I am not asking you to commit yourself, I just wanted to find out if, substantially, that is the basis of the difference between the two estimates.

Mr. Adams: Well, I would like to ask Mr. Cockburn one question to help me in giving your Honor my answer.

Q. Leaving out of account the effect of deductions, Mr. Cockburn, the three deductions that are taken account of in this schedule, have you made any figure to determine the variance or approximate variance between the computations you have made and the computations which Mr. Buchanan made on his Basis 2 of Plaintiff's Exhibit 80?

A. No.

Mr. Adams: Well, perhaps we can bring that to your Honor in the morning. We can give you a figure that would more accurately answer your Honor's question.

The Court: Well, it just kind of looks like it to me, and that is why I asked the question, because I see there is about \$10,000,000 and if you add that to \$7,000,000—well, you get pretty close to it. There must be some other figures involved in it, but it looks to me as if that might be the substantial difference.

Mr. Adams: The witness has stated he has taken

(Testimony of James L. Cockburn, Jr.)

account of some inter-company interest deductions that Mr. Buchanan did not take account of, and some other factors. [1420]

The Court: There might be some other factors.

Mr. Adams: I think your Honor is right.

The Court: It seems to me the bigger amount by way of difference are these figures.

Mr. Adams: I believe that is true; and furthermore, I believe that Mr. Buchanan gave some figures on accelerated amortization that somewhat resemble the figures that are produced on this exhibit. So that the larger deductions are the latter two in effect. Mr. Buchanan said himself that he hadn't taken off accelerated amortization in producing his Basis 2 figures, but he gave us some figures when we talked with him about it.

Mr. Phleger: I don't like to interrupt, but would it not be helpful if this witness, in the morning, could give us the figures without these adjustments?

Mr. Adams: Well, it is a little quick work; these things don't get done in five minutes.

Mr. Phleger: In other words, if he gave us the figures without the adjustments, then you would have the comparable figures for Basis 2.

The Court: Well, maybe you can calculate that.

Mr. Adams: Let me suggest this: Mr. Cockburn and Mr. Buchanan have been discussing this matter one with the other.

Q. Have you not? A. That is correct.

Mr. Adams: I think Mr. Buchanan can produce

(Testimony of James L. Cockburn, Jr.)
the figures [1421] for Mr. Phleger that the plaintiff desires.

The Court: I only asked the question because it would seem to me that the thing could centralize on these figures here that you are examining him about. That will create the real issue as between the two estimates.

Mr. Phleger: That is correct.

Mr. Adams: Well, I think in addition to that we can produce a figure of our own—or at least I hope so. If we have any substantial variance with Mr. Buchanan's figures, on his own hypothesis, that is.

The Court: I think that would be helpful, Mr. Adams.

Q. (By Mr. Adams): Now, Mr. Cockburn, referring—wait a moment, didn't I have an open question, your Honor, and then your Honor asked a question?

The Court: Yes, you asked him the basis of these figures on accelerated amortization, and then is when I interrupted you. There is where there was some question like that asked by you, I seem to recollect.

Mr. Adams: That is what it was about, yes, your Honor.

Q. Would you state the basis of the deductions taken here for accelerated amortization? When I say "taken here," I mean on 41 for identification

A. Under the provisions of the Internal Revenue laws, a taxpayer which had constructed an emer

(Testimony of James L. Cockburn, Jr.)

gency facility for war purposes was permitted to amortize the cost of the facility over [1422] a 60-month period, with provision in the law that if the war ended earlier, and by proclamation of president, they would then have the election of amortizing the cost of the facility over the period from the date the facility was completed to within a certain period of time after the date of proclamation, or to take the balance of the amortization over the normal life of the asset involved.

The Court: Was 1942 the first year, then, that that could be availed of?

The Witness: That was the first year in which, your Honor, the Western Pacific Railroad Company had any assets constructed under these provisions of the law. I am not sure whether it began, or actually could have started in 1941 or '42, if they had facilities in an earlier year.

Q. (By Mr. Adams): Now, Mr. Cockburn, referring to the deductions as indicated on 41 for identification, during the four years, 1941, 1942, 1943, and the first four months of 1944, for United States Government freight cut-backs, refunds, will you please state the deductions you have taken in your computations for those freight cut-backs and refunds? [1423]

Mr. Phleger: Now excuse me for interrupting; I am trying to be helpful. Are you dropping the amortization claim now? Because in our view, the witness has not supported at all his deductions. He

(Testimony of James L. Cockburn, Jr.)

has stated what the law is, but he hasn't stated what the facts are.

Mr. Adams: Well, my recollection is that Mr. Buchanan, the witness, came out about the same with these figures. I am not dropping it at all; I don't have any query in my mind about it. What is your question as to amortization?

Mr. Phleger: Well, I would say before any foundation was laid, for any such deduction, you would have to show how much the emergency facilities were that were constructed, and when they were constructed, the years in which they were taken, how he readjusted them, and what the tax credits by this readjustment were that the company received that should have been offset by these additional amounts.

Mr. Adams: Can you answer Mr. Phleger's question?

A. The first portion of his question I might answer by stating that the information from which these figures were computed appears in the tax returns which were filed. The portion of the amortization, the facilities, are listed in the schedule attached to the return, and the computation of the accelerated portion of that amortization, which is listed here, was determined from the information appearing there. [1424]

Mr. Phleger: Yes, but not in returns that are in evidence.

Mr. Adams: If your Honor please, I didn't surrender the witness altogether.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: No, but I wanted to be helpful. I will not ask any further questions. I will have to object to this exhibit on the acceleration matter, because there is no proper foundation. The information that he refers to in our later returns——

The Court: Well, he will have to develop that inquiry first.

Mr. Adams: The witness has been interrupted, I thought, in his answer, and I would like to have him continue with his answer.

Mr. Phleger: Excuse me.

A. (Continuing): These computations were made by us from the information appearing in the returns for the years '42, '43 and '44, and we assumed in making these computations that the taxpayer, the Western Pacific Railroad Company, would have elected to claim the benefit of accelerated amortization if it had been to its benefit to do so.

Q. (By Mr. Adams): Now, making that assumption, did you find in the returns as filed the figures from which you were able to compute the deduction for account of accelerated amortization, if that election were exercised? [1425]

A. I did.

Q. Those figures you found in the returns as filed?

A. That is correct.

Q. Were they all that you required as an accountant, a tax accountant, to satisfactorily compute that deduction?

A. That is correct.

Q. Now, then, may I turn to the item of deduction for the United States Government freight cut-

(Testimony of James L. Cockburn, Jr.)

backs and refunds; and I will ask you to explain that deduction appearing for the four years I mentioned.

A. The figures from which these deductions were computed were obtained from the general auditor's office of the Western Pacific Railroad Company, and a sum was obtained, an approximate total freight cut-back of \$2,000,000 for the period '42 to '46.

Q. Now, then, what method did you use in determining the particular amounts of the deductions applied to '41, '42, '43 and the first four months of '44, out of that total of \$2,000,000?

A. These are based on the actual figures obtained from the general auditor's office and rounded out to the nearest \$10,000.

Q. So that you obtained actual figures for each of the particular periods which are indicated here, each of the particular years, and part of the year, which are indicated here on 41 for Identification?

A. That is correct.

Mr. Phleger: Do I understand that these figures were given to the witness or that he got them out of the files?

The Witness: They were given to us.

Mr. Phleger: Then I move that that matter be stricken out as hearsay.

Mr. Adams: Well, your Honor, it is just a question of connecting up. I am putting in a computation at this time, and I assume that with an objection of this sort, it will be necessary for me to

(Testimony of James L. Cockburn, Jr.)

produce the witness who has taken two months to make the particular computation on this calculation, on which this calculation is predicated.

The Court: Yes. Well, subject to its not being connected up you can, of course, move to strike it out.

Q. (By Mr. Adams): Now, Mr. Cockburn, will you please explain the deduction of some \$8,500,000 in 1943 on account of the partial bad debt loss on Sacramento Northern Railway notes and advances?

A. On December 31, 1943, Sacramento Northern Railway Company, a wholly owned subsidiary of Western Pacific Railroad Company, owed to the Western Pacific Railroad Company on unsecured notes and open account advances the amount of \$9,474,100.80. Mr. Elsey has informed us that in his opinion these notes and advances were worth only 10 per cent of face at that time.

Q. That is in what year? [1427]

A. In the year 1943.

Q. Now, could a deduction have been taken on account of a part of that indebtedness in 1943?

A. It could.

Mr. Phleger: Just a moment. I move that that be stricken out on the ground that it is a conclusion of the witness. And no proper foundation laid, a legal matter.

Mr. Adams: Well, we don't expect to bind his Honor as to any legal matter, but certainly the man who made the computations should be in a

(Testimony of James L. Cockburn, Jr.)

position to explain it, and that is the purpose of these questions.

Mr. Phleger: Well, that is an entirely different matter. He is acting upon a certain assumption.

The Court: Well, of course this is just a computation. I don't think that the witness is offering to testify in order to prove that that is a proper deduction.

Mr. Adams: Certainly not, your Honor.

Mr. Phleger: That was the question that was asked him, namely, could this deduction be taken in that year.

The Court: Well, that depends upon the facts as to whether that would be a proper deduction.

Mr. Adams: Of course, your Honor. But the witness knows something about this, and I think he should state from his point of view as an expert accountant the basis on which a deduction, speaking as an expert accountant, could have been [1428] taken in a return for that year. It wouldn't be binding on your Honor, nor on any party, but it will explain how the witness makes the deduction, and it is for that purpose that I ask the question.

Mr. Phleger: Now, there is pending a motion to strike out the previous question and answer. The witness was asked whether or not this could be deducted in that year. He said "Yes," and I moved that it go out.

The Court: Yes, I think that motion is good. You can ask the witness to give the reasons why he included it in his computation.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: Thank you, your Honor. He may do that.

The Court: That, of course, wouldn't be a statement that it was deductible in that year.

Mr. Phleger: No, because this is a legal question, not an accounting question.

The Court: That is right. I think there is no doubt about that.

Q. (By Mr. Adams): Would you state the reasons, Mr. Cockburn, why you included this item in your calculations, including the same deduction in your calculations on 41 for Identification?

Under the provisions of Section 23(k) of the Internal Revenue Code, a taxpayer is permitted to claim a deduction for a debt which is partially worthless, and may claim that portion of the debt down to the point to which it is worthless, [1429] and which is written off in the year in which it is deducted.

Mr. Phleger: Now may it please the Court, that is a legal answer. He is quoting the law.

Mr. Adams: He is stating his understanding.

Mr. Phleger: We don't agree that the law justifies this deduction.

Mr. Adams: Well, your Honor, we shall never contend——

The Court: That is the reason he put in this tabulation. That is the effect of the testimony. I will allow it for that purpose. That doesn't prove that it is a proper deduction.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: Surely.

The Court: It merely indicates the reason on the part of the man who made the tabulation for including it.

Mr. Adams: We shall always contend the witness is an excellent tax accountant, but any question of law is for the Court.

Q. Now, Mr. Cockburn, upon what hypotheses or assumptions did you include this particular deduction in the computations in Defendants' Exhibit 41?

A. Upon the assumption, first, that it was worth only 10 per cent of face on December 31, 1943; secondly, that it had been written down by a 90 per cent amount in the accounts for that year; and, thirdly, that no deduction had been claimed for this amount in prior years, and allowed.

Q. And did you also assume, as I think you stated in your [1430] schedule, that the railroad company filed a separate return for that year?

A. The railroad company was included in a consolidated return for the year 1943.

Q. Yes. I am asking you upon what assumptions you included this deduction in your computations. That is No. 41 for Identification.

The Court: He has already said that this is a schedule that refers to the filing of a separate return for these years by the committee. What this amounts to is if it is a good deduction, why, then, it could be taken. That is all.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: Yes, your Honor.

The Court: And that if it were taken, this would be the result of the calculation.

Mr. Adams: I perhaps could just get one question on this, and finish with this particular exhibit.

The Court: Very well.

Q. (By Mr. Adams): In your opinion, Mr. Cockburn, do the computations you have made on Defendants' Exhibit 41 for Identification state correctly the tax liability of the Western Pacific Railroad Company for Federal income and excess profits taxes for the years 1942 and 1943, and the first four months of 1944, on the basis of the assumptions that are described in the computation, and to which you referred in your testimony?

A. They do. [1431]

Mr. Phleger: Well, just a moment. I will object to that. He stated what he did. Now, some of the assumptions are on this document. There are some other assumptions that are in his testimony, and I am sure we are going to find there are a lot of other assumptions. I think this should rest, that this is a computation made on the basis that he has testified to, and that the accuracy of the figures on that basis, that he believes the figures are accurate on that basis, not that the tax liability is as shown.

Mr. Clark: The question calls for his testimony that this is a correct tax liability upon this.

Mr. Adams: Oh, on the basis of the assumptions that were included in my question, your Honor, it

(Testimony of James L. Cockburn, Jr.)

is a computation of tax liability on the basis of the various assumptions that are indicated.

The Court: I don't see any objection to that. I will overrule the objection.

Mr. Adams: And I will offer the document, then, now, as Defendants' Exhibit 41.

Mr. Phleger: Well, now, I——

Mr. Adams: Subject to being connected up.

Mr. Phleger: I don't think the foundation has been laid at all for these assumptions.

The Court: Well, I think all this amounts to is that having these, without any question as to the validity of the [1432] various deductions that are taken, that if they were taken, the calculations would be as stated in this.

Mr. Phleger: Well, that is all right.

The Court: Well, that is the way I understand the testimony.

Mr. Clark: Or if they could be taken.

Mr. Phleger: In other words, if they could have been taken upon the basis stated, that this is the tax that he figures out would have been paid.

The Court: Well, I think that is what Mr. Adams had in mind.

Mr. Adams: That is right, your Honor, and I understand further that it will be obligatory on my part to connect up, by another witness, the cut-back and refund figures that are shown here on this exhibit.

Q. It is a fact, is it not, Mr. Cockburn, that the figure for the Sacramento Northern Railway notes

(Testimony of James L. Cockburn, Jr.)

and advances is 90 per cent of the amount of these notes and advances as of the end of the year 1943?

A. That is correct.

(Defendants' Exhibit 41 for Identification was received in evidence.)

Mr. Adams: I have no further questions this afternoon, your Honor. If it is an appropriate time to recess?

Mr. Phleger: Before adjournment, do I understand, Mr. [1433] Adams, that this witness will have the figure as to what the computation would be without the deductions down below?

Mr. Adams: I don't think so. I think you can get it easily from Mr. Buchanan. I think this witness will be very busy, but we will do the best we can. But why don't you try Mr. Buchanan?

Mr. Phleger: Well, after all, these are his figures (indicating).

Mr. Adams: No, you were asking for a comparison with Mr. Buchanan's figures.

Mr. Phleger: I am not asking for a comparison, I am asking what figures this witness would show without the deductions.

The Court: Can you figure that?

The Witness: No, we have not figured that.

The Court: You didn't make any calculation leaving out these items of amortization and cut-backs for the Sacramento Northern? That is, you didn't make any calculation leaving out those figures

(Testimony of James L. Cockburn, Jr.)

as to what the tax would be if a separate return was filed? Or did you?

The Witness: We have made quite a number of computations, your Honor, and I couldn't be too certain. I don't think we have. That takes a little while; it would be a different set of computations, and a different net operating loss carry-over, excess profit credits and other elements entering into the computations. They are very involved computations. [1434]

The Court: That may be so.

Mr. Phleger: Then there will be no estimate on this basis if these assumptions are not correct or any of them. [1435]

* * *

JAMES L. COCKBURN, JR.

resumed.

Direct Examination
(Continued)

By Mr. Adams:

Q. Mr. Cockburn, since yesterday's session have you made a rough computation of the amount of tax liability which the Western Pacific Railroad Company would have incurred on the various assumptions contained in Defendants' Exhibit No. 41, exclusive of the deductions that are described in note 1 to that schedule? A. I have.

Q. What is the amount?

A. Approximately \$14,800,000.

Q. I would like to call your attention to the

(Testimony of James L. Cockburn, Jr.)

computation described as Basis 2 in Plaintiff's Exhibit No. 80. Do you have a copy of it?

A. I have.

Q. That computation shows a total tax liability of approximately \$15,572,000 for the Western Pacific Railroad Company for the same period on the assumptions stated in that document?

A. That is correct. [1437]

Q. I direct your attention to the fact that the difference between that figure and the one you have just given is about \$771,000, and I will ask you if you will tell the Court briefly the principal factors accounting for that difference.

A. The principal factors are the deductions claimed by us in our computations for interest on inter-company holdings of indebtedness, the repositioning of the Deep Creek loss from 1940 to 1939, the elimination as a deduction in 1940 of reorganization expenses, the changes required in the computation of the net operating loss, and reversing excess profits credit carry-overs, result in a difference in our bases; and also other minor inaccuracies which are not material to the computations and which can probably be corrected.

Mr. Adams: At this time, your Honor, I offer for identification a schedule dated February 16, 1949, marked C, consisting of one page entitled "Western Pacific Railroad Company Federal Income and Excess Profits Taxes for Years 1942 and 1943 and the First Four Months of 1944," on the basis of assuming that the Western Pacific Railroad

(Testimony of James L. Cockburn, Jr.)

Company had filed separate returns and had the benefit of its own net operating loss carry-overs and excess profit carry-overs, computed as though it had filed separate returns in prior years, and the additional deductions from income as shown in the note below.

I believe that will be 43 for Identification.

(The document referred to was marked Defendants' Exhibit 43 [1438] for Identification.)

Mr. Adams: May I ask that a copy be handed up to his Honor.

Q. Mr. Cockburn, do you have a copy of that schedule C in your hands? A. I do.

Q. You also have a copy in your hands of Schedule D, which is now Defendants' Exhibit 41?

A. I do.

Q. Will you please explain to the Court the difference between Schedule D introduced yesterday as Defendants' Exhibit 41 and this Schedule C, which you have in your hands.

A. The computations in Schedule C are based on exactly the same figures as used in Schedule D, with the exception of the amount deducted for United States Government freight cut-backs and refunds. Those in Schedule D were on the basis of a total of approximately \$3,000,000 for the period 1942 to 1946, and on Schedule C on the basis of \$3,000,000.

Mr. Adams: Will you read the answer?

(Answer read.)

(Testimony of James L. Cockburn, Jr.)

The Witness: I wish to correct that answer. The computations in Schedule D were on the basis of \$2,000,000 for the period for United States Government freight cut-backs and refunds, and the computations in Schedule C are on the basis of \$3,000,000 for the same deductions. [1439]

Q. (By Mr. Adams): That is the only difference between Schedule D, which is Exhibit 41, and this Schedule C in your hands?

A. That is correct.

The Court: That is about \$370,000?

The Witness: That is correct, your Honor.

Q. (By Mr. Adams): And so that your testimony yesterday, stating the bases, and assumptions on which you prepared Schedule D would apply likewise to this schedule with that one difference?

A. Yes, it would.

Mr. Adams: I will offer the schedule previously marked 43 for Identification as Defendants' Exhibit 43.

Mr. Phleger: I object to the receipt upon the ground that it is incompetent, irrelevant and immaterial and also upon the basis that the assumptions shown to have been made with respect to this item are contrary to the evidence in the record.

The Court: Well, I admitted the other exhibit merely as a computation, not as proof of the validity of any of the deductions claimed therein—but only as a computation assuming the validity of the deductions, that the tax would be so much.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: Yes. I think that the assumptions, or some of the assumptions, are contrary to the evidence in the record. If I can simply have my objection noted, I have no——

The Court: Well, I take it, Mr. Phleger, that Mr. Adams is perhaps putting this on, shall we say, a little bit out of [1440] order, as he may be intending to put in some other kind of evidence to sustain the validity of these deductions which are asserted in this return, or to make some legal showing on that.

Mr. Adams: I would like to respond to your Honor on that. With regard to the deductions for accelerated amortization, we consider they have been proved. With regard to the deduction for partial bad debt loss on the Sacramento Northern Railway notes and advances, we consider we have offered all of the proof, and our own proof is that that deduction is based upon the hypothesis that the partial loss was written into the books in 1943, which it was not, in fact. So that this is a hypothetical approach on a separate tax return basis. With regard to the United States Government freight cut-backs and refunds, the third item of deduction in this computation, I stated yesterday to your Honor that I would have to connect up the \$2,000,000 figure, Mr. Elsey having spoken about that as the actual figure, but having gotten his information from his auditing department. So I will have the witness here to testify to that actual \$2,000,000 figure.

(Testimony of James L. Cockburn, Jr.)

Now, this Exhibit C carries that deduction on the \$3,000,000 basis. Mr. Elsey testified to an estimate of an additional million dollars, and that is just why this is \$3,000,000 in this schedule whereas it was \$2,000,000 in the other schedule.

Mr. Phleger: But Mr. Elsey also testified that he was [1441] unable to allocate those statements to any year.

The Court: Well, of course, now we are getting into an argument as to the effect of the testimony with respect to these items. I see no harm in, subject to the limitations stated, allowing the computations in; so that if it appears that there is validity to the deductions, the Court will have before it a calculation showing the amounts involved. If it appears that there isn't validity to these deductions, then the schedules will be of no importance in the matter.

Mr. Clark: Well, may it be understood, your Honor, that they are admitted subject to motions to strike in the event they are not connected up?

The Court: I think perhaps that might be the best way of handling it, so with the statement that the Court has made, that these two exhibits—has 41 been admitted here?

Mr. Adams: Yes, your Honor.

The Court: So that 43 may be admitted on the same basis as 41 was admitted, plus the conditions that the Court has just included in admitting the statement in evidence.

(Testimony of James L. Cockburn, Jr.)

(Defendants' Exhibit 43 for Identification was received in evidence.)

Mr. Adams: I take it the same understanding should apply to Plaintiff's 80, the computation the plaintiff has introduced?

Mr. Phleger: Oh, not at all. They were mathematical computations from the income taxes. [1442]

Mr. Adams: I am not arguing how good or bad they were, merely if there is to be an open proposition about a motion to strike as to our computations, we should, by parallel reasoning, have the same right.

The Court: Well, of course, on the face of the case it would involve the amount of taxes, both sides can argue as to the effectiveness of their computations with respect to taxes. I don't think we need to make any particular rulings on that at this time.

Mr. Adams: No. I just asked for parity of treatment.

The Court: It is very obvious what these schedules are for. One side says, "Now, if we win the case we have to show what the saving of income tax was. This is our calculation of what it was. It is based on certain factors." The other side says, "Well, even if you do win the case, it isn't as much as you say, because these other factors have to be taken into account."

Now, that is one of the issues the Court will have to determine, and the schedules merely assist the

(Testimony of James L. Cockburn, Jr.)

Court in fixing the amounts, depending upon which respective contention is established. That is all. Now, I think with what we have said, we understand one another, and each side's rights are protected in the record.

Mr. Adams: Now, if your Honor please, I offer for identification the single schedule sheet dated February 16, 1949, [1443] marked B, entitled "The Western Pacific Railroad Company Federal Income Taxes for 1942 and 1943 and the First Four Months of 1944, on the Basis of Assuming That the Western Pacific Railroad Company Had Filed Separate Returns and Had the Benefit of Its Own Net Operating Loss Carry-overs and Excess Profits Credit Carry-overs Computed as Though It Had Filed Separate Returns in Prior Years, and the Additional Deductions from Income as Shown in the Note Below," and I will ask that a copy be handed up to his Honor.

(Copy of document handed to Court.)

(The document referred to was marked Defendants' Exhibit 44 for Identification.)

Q. (By Mr. Adams): Mr. Cockburn, do you have a copy of the schedule B, now marked Defendant's 44 for Identification, in your hands?

A. Yes.

Q. Now, in this Defendants' 44 for Identification, at what figure is the deduction for United States Government freight cut-backs and refunds taken?

A. \$2,000,000.

(Testimony of James L. Cockburn, Jr.)

Q. And then what difference is there between Defendants' 44 for Identification and Defendants' 41, the schedule introduced yesterday, in which the cut-backs were taken at the same figure?

A. You refer to Schedule D? [1444]

Q. Yes.

A. The difference between those two schedules is that in Schedule B, identified as B, we have deducted United States Government reparations as claims in the amounts indicated, and in the years indicated, based on total reparations claims of \$12,000,000.

Q. Now, the figures you have there on that matter are stated under the years 1942, 1943 and 1944. Can you explain what relation those figures bear to the \$12,000,000 figure which you assumed on account of the reparations claims?

A. We went to the company's office, and from certain records there obtained totals of the Western Pacific Railroad Company's United States Government freight for the years 1942 to 1946, inclusive. And we assumed that the \$12,000,000 should be prorated over the years in proportion to the amounts of United States Government freight in the years 1942 to 1946.

Q. And I take it you yourself do not take any responsibility for the \$12,000,000 figure which was supplied to you as an assumed figure over the whole period for the amount of reparations?

A. That is correct.

Q. And this, then, is a computation, this Sched

(Testimony of James L. Cockburn, Jr.)

ule B, Defendants' 44 for Identification, which involves in addition to the hypotheses and assumptions on which 41 is based, the further assumption that deductions may be taken for reparations claims, and that such deductions would apply to the tax years in [1445] question; you have both of those assumptions, do you not, in respect of the deduction for the reparations claims in this schedule?

A. That is correct.

Mr. Adams: I offer the document, your Honor, as Defendants' Exhibit 44, and not as in any wise proof of the validity of that last deduction, but as the computation which will be made, assuming that any figure can be made for the amount of reparations claims. We know, of course, that at present that litigation between the Government and the carriers has not proceeded to a point upon which any definite figure can be ascertained.

Mr. Phleger: May it please the Court, I object to the admission of this proposed exhibit upon the ground it is irrelevant, incompetent, immaterial and no foundation has been laid for it. We had an extensive discussion, as you will recall, upon this matter and on our objection to the admission of this evidence, which was sustained.

Mr. Clark: Same objection.

Mr. Phleger: That is, claims predicated upon railroad reparations.

The Court: I think counsel is entitled to have in the record a calculation that would show what

(Testimony of James L. Cockburn, Jr.)

the situation would be if the evidence were proper. I see no objection to allowing it merely as a calculation. It is not offered in proof of [1446] any of the facts stated.

Mr. Phleger: Your Honor, in the course of the argument it was demonstrated that this is a reparation matter pending before the Interstate Commerce Commission, which all the railroads resist as being absolutely unfounded. It not only involves validity of claims, but it involves the amount of claims and it involves the assumptions that are made as to the spreading of the claims.

The Court: Mr. Phleger, I understand all of that, but counsel on the other side seems to think he should have a calculation in the record. It does not prove anything, and if there is no validity to the deduction, then the calculation does not mean anything. I see no harm in allowing it as a calculation subject to those conditions.

Mr. Clark: And subject to a motion to strike.

The Court: Subject to a motion to strike.

(Defendants' Exhibit 44 for Identification was received in evidence.)

Q. (By Mr. Adams): Mr. Cockburn, I ask you to turn for a moment to Defendants' Exhibit 43, the schedule marked C, and referring to the amounts shown there on Defendants' 43 for the freight cutbacks and refunds, please state what procedure you followed in calculating and computing those amounts for each of those years.

(Testimony of James L. Cockburn, Jr.)

A. The United States Government freight cut-backs and refunds [1447] on Schedule C are based on figures obtained from the general auditor's office and rounded out to the nearest \$10,000.

Q. Referring to the fact that on Schedule D, Defendants' 41, the figures for the same deduction are in each case lower, and in that Schedule 41 aggregate approximately \$2,000,000—do you bear that in mind? A. Yes.

Q. Is that correct?

A. I probably should explain that on Schedule C the figures are based on the figures obtained from the general auditor's office increased by 50 per cent.

Q. In other words, the method by which you got your cut-backs and refund figures in Defendants' 43, marked C, was to increase roughly by 50 per cent the figures that are shown for the same deduction in 41 marked D?

A. That is correct.

Mr. Adams: If your Honor please, I offer for identification as Defendants' 45 a schedule marked A, dated February 16, 1949, consisting of one page and containing a title similar to the title of the papers previously offered, that is, the Exhibits 41, 43 and 44. I hand up a copy to the Court.

(The document referred to was marked Defendants' Exhibit 45 for Identification.)

Q. (By Mr. Adams): Mr. Cockburn, referring to this schedule marked A, February 16, 1949, Defendants' 45 for Identification, [1448] will you

(Testimony of James L. Cockburn, Jr.)

please state to the Court what difference there is between that schedule and the schedule marked B, Defendant's 44?

A. The only difference between those two schedules is that in Schedule A the United States Government freight cut-backs and refunds are based on a \$3,000,000 figure, whereas in Schedule B they are on a \$2,000,000 figure.

Q. And otherwise the Schedule A is based on the same assumptions and hypotheses on which the Schedule B, Defendants' 44, was based?

A. That is correct.

Mr. Adams: I will offer the exhibit now marked Defendants' Exhibit 45 for Identification as Defendants' Exhibit 45. It does contain figures in addition for the reparations claim, as your Honor will note, and the statement, of course, that I just made applies with respect to that matter.

Mr. Phleger: May I note the same objection and reserve a motion to strike?

The Court: The exhibit will be admitted subject to the same objection, under the same conditions, and subject to the same motion to strike.

(Defendants' Exhibit 45 for Identification was received in evidence.)

Mr. Adams: If your Honor please, I offer as Defendants' Exhibit 46, and hand up a copy to the Court, for identification, [1449] a single sheet entitled "Western Pacific Railroad Corporation Federal Income Taxes for the Years 1922 to 1944

(Testimony of James L. Cockburn, Jr.)

Inclusive, on the Basis of Assuming That the Western Pacific Railroad Corporation Had Filed Separate Returns and Comparison Thereof With Taxes Allocated to That Company on the Basis of Consolidated Returns Filed Dated January 14, 1949."

(The document referred to was marked Defendants' Exhibit 46 for Identification.)

Q. (By Mr. Adams): Mr. Cockburn, do you have a copy of that schedule, Defendants' 46 for Identification, in your hands? A. I do.

Q. Now, have you computed the taxes which the Western Pacific Railroad Corporation would have paid during the period 1918 to 1944 if it had filed separate returns whenever permissible?

A. I have.

Q. And I have handed you this document, Defendants Exhibit 46 for Identification. Did you find that the corporation would have paid \$593,-976.33 more on a separate return basis than it actually did pay during the period on a consolidated return basis? A. I did.

Q. And that is the figure appearing at the bottom of the last column of this tabulation, Defendants' 46 for Identification? A. Yes.

Q. You believe that the tabulation is correct?

A. I do.

Mr. Adams: I will offer the document, your Honor, as Defendants' Exhibit 46.

Mr. Phleger: I wish to object to its receipt upon the ground it is incompetent, irrelevant and imma-

(Testimony of James L. Cockburn, Jr.)

terial, just like all of the other previous records.

The Court: It goes to the weight of that phase of the testimony that counsel is offering. I will overrule the objection.

(Defendants' Exhibit 46 for Identification was received in evidence.)

Mr. Adams: I offer as Defendants' 47 for Identification a single sheet schedule dated February 15, 1949, entitled "Western Pacific Railroad Company Federal Income Taxes for the Years 1922 to 1941, Inclusive, on the Basis of Assuming That the Western Pacific Railroad Company Had Filed Separate Tax Returns and Comparison Thereof With Taxes Allocated to that Company on the Basis of Consolidated Returns Filed," and ask that this be marked Defendant's 47 for Identification, and I would ask that a copy be handed up to his Honor.

(The document referred to was marked Defendants' Exhibit 47 for Identification.)

Mr. Phleger: Have you copies of that?

Mr. Adams: Yes. I gave them to you yesterday.

Mr. Clark: We do not have a copy of that.

Mr. Adams: Yes; I handed three copies to counsel yesterday.

Mr. Levy: We have everything else, but not that.

Mr. Adams: I do not know what happened to them, because, of course, we were handing all these papers to you.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: That is all right. We can get it later.

Mr. Adams: Would you like to come and look at it as I talk about it?

Mr. Phleger: We are going to object to it anyhow.

Q. (By Mr. Adams): Mr. Cockburn, have you computed the taxes which the Western Pacific Company would have paid during the period 1922 to 1941, inclusive, if it had filed separate returns whenever permissible during that period?

A. I have.

Q. Did you find that the Western Pacific Railroad Company would have paid during that period \$408,869.51 more on a separate return basis than it actually did pay during this period on a consolidated return basis? A. I did.

Q. That is the figure appearing in this tabulation at the bottom of the column?

A. That is correct.

Q. You believe it is correct? A. I do.

Mr. Adams: I will offer this document as Defendants' 47, and as your Honor will see, we are really proving a converse [1452] here for the benefit of our adversaries.

The Court: You are showing the advantage of a consolidated return.

Mr. Adams: Both ways, and the net advantage to the plaintiff corporation.

Mr. Phleger: We say there is only one advantage to the consolidated return and that is to the

(Testimony of James L. Cockburn, Jr.)

parent corporation. May I note the same objection?

The Court: Yes. The exhibit will be admitted under the same conditions.

Mr. Adams: I take it the plaintiff cannot have 47 without having 46. The two things are correlative, one with the other.

(Defendants' Exhibit 47 for Identification was received in evidence.)

Q. (By Mr. Adams): Mr. Cockburn, have you examined Plaintiff's Exhibit 80 in this case, consisting of computations of income taxes for the plaintiff corporation and its affiliates on three separate bases for the years 1942, 1943, and the first four months of 1944?

A. Do you refer there to Basis 1?

Q. I referred to all three bases, and asked you if you had examined Plaintiff's Exhibit 80, which consists of all three bases?

A. I have. [1453]

Q. Do you have a copy of it in your hands?

A. I have.

Q. Would you look, please, at the first page of Plaintiff's Exhibit 80, in which is set forth the so-called Basis 1. Have you made an effort to check Basis 1?

A. Yes.

Q. Do you agree that Basis 1 is a correct statement of what the tax liability of these companies would have been if they had filed separate returns for the period indicated, using data actually shown on the consolidated return without any change or

(Testimony of James L. Cockburn, Jr.)

adjustment? A. No, I do not.

Q. In what respect do you think that these computations on that assumption or hypothesis are incorrect?

A. These computations fail to claim a deduction for intercompany interest. The net operating loss carryovers are not included; excess profits——

The Court: This schedule is without the carryovers. There is a separate schedule in it that covers that.

Mr. Adams: That is right, your Honor. I take it the witness is commenting on certain matters that he thinks would necessarily be taken into consideration merely from taking the figures off the returns.

The Court: That is going to be confusing now, because there is a separate schedule on it. [1454]

Q. (By Mr. Adams): Mr. Cockburn, leaving out any reference to net operating loss carryovers and any reference to unused excess profits credit carryovers, you have stated, as I understand it, that the computations are incorrect in that the intercompany interest deductions were not restored.

A. That is correct.

Q. Is there any other correction, if you leave out those carryovers that I have mentioned, that you think should be made in the figures shown on the returns to correct the figures shown on Basis 1?

A. Net operating loss carrybacks within the period were not deducted.

Q. If the figures were corrected so as to take

(Testimony of James L. Cockburn, Jr.)

proper account of the two factors that you have mentioned, your restoration of the deductions and the allowance for carryback of net operating losses, do you believe that the figures would then show the amount of tax which those companies would have been required to pay for this period if they had filed separate instead of consolidated returns?

A. No.

Q. And why not?

Mr. Phleger: I object to that. This is merely an argument of some of the basic legal propositions involved in the case. He is not attacking the computation. He is saying this is not the way to determine what the tax saving is. On the same [1455] basis all of these last exhibits would have been rejected, it seems to me.

Mr. Adams: This is a computation. It states on its face what it is.

The Court: This computation, Mr. Cockburn, of Basis 1 would be correct in your opinion, would it, as a computation were it not for the fact that these interest payments that you refer to were not included? I am talking about it now as a computation. Forget about the argument that you make as to the validity of the deductions; just as a computation. The thing that is wrong with it as a computation is—what amount did you come to on that? Was it about \$300,000 of interest?

A. No.

Q. You mentioned some amount.

Mr. Adams: We gave a difference of—

(Testimony of James L. Cockburn, Jr.)

The Witness: \$770,000 approximately.

Mr. Adams: ———of approximately \$770,000, but that was as to Basis 2, was it not, Mr. Cockburn?

The Witness: That is correct.

Mr. Adams: The Judge is asking about Basis 1.

The Court: Now, what I am trying to find out, and I think it will shorten this matter, is that you have before you a computation of one of your competitors here.

The Witness: That is correct.

The Court: And all we want to know, or all I want to know at this stage of the proceeding is, is that a correct calculation. I take it it would be correct as a calculation, were it not for the failure to include this interest item that you speak of. But as a calculation, and irrespective of the validity of the various deductions and the right to take them.

The Witness: There is one element I would like to explain there, your Honor, before I answer that categorically **yes or no**.

The Court: All right.

The Witness: The net operating loss deductions —strike that. No adjustment has been claimed for accelerated amortization, which the company might have elected to take.

Mr. Phleger: Well, that is not shown on the returns.

The Court: This is a calculation, as I recall the testimony, that was taken from information on the

(Testimony of James L. Cockburn, Jr.)

consolidated return. Now all we want to know is, as a calculation of the information on the consolidated return, is this a correct calculation? Forget about whether the deductions are right.

Mr. Adams: Now if your Honor please, may I suggest that your Honor's question carries within its content some different—— [1457]

The Court: Well, I will get somebody myself to calculate it. It seems to me that what I am suggesting is a very simple matter.

Mr. Adams: Your Honor, I think it is, if the witness——

The Court: And if Basis No. 1 wasn't calculated correctly from the return, somebody can tell me that without going into the legal questions as to the validity of the various deductions involved. That is all it was offered for.

Mr. Adams: That is right. What I think is implicit in the witness' mind, and of course I don't know, but I am assuming this, is that when he is asked about the correctness of calculations he has in his mind that this Basis 1 assumes to be some kind of an approach to what the tax liability would have been on a hypothesis, and so really is different; that there are various computations which, in his view, should have been included in this which aren't made here.

Q. That is right, is it not, Mr. Cockburn?

A. That is correct.

Q. So that, to answer his Honor's question, you

(Testimony of James L. Cockburn, Jr.)

think, as far as the arithmetic goes, as far as this computation is concerned, you don't quarrel with the arithmetic but you point out certain deductions you mention which should be included, and that certain allowance for carry-backs were not included that you would include if you were to make a computation like that?

The Court: Well, of course that is obvious, and it was [1458] obvious from the testimony of Mr. Buchanan that those items were not included in his calculation.

Mr. Adams: And does that answer your Honor's question?

The Court: Am I right about that, Mr. Cockburn?

The Witness: The answer is "yes" to your question on that basis.

The Court: All right.

Mr. Phleger: Well, can't we get a figure? I don't want to interrupt, but can't we get Mr. Cockburn's check of the figure that appears on Basis 1 of——

The Court: He just said it is correct.

Mr. Phleger: Oh, it is correct. Oh.

The Court: Without it being admitted that these factors that he has in mind were not included.

Mr. Adams: But your Honor, we shall contend, of course, that is manifestly incorrect, because such consideration should be taken into account.

The Court: Well, I don't deprive you of that right. I understand that.

(Testimony of James L. Cockburn, Jr.)

Q. (By Mr. Adams): Now I would like to turn to Basis 2, Mr. Cockburn, in Plaintiff's Exhibit 80, and then turn to your schedule, Defendant's—no, not the schedule.

Bearing in mind that I asked you this morning if you had made a computation of the tax liability which would have been incurred on the various assumptions in our Exhibit 41, but [1459] excluding the deductions—you recall giving that testimony?

A. I do.

Q. And you recall that your brief computation of that amount came out at about \$14,800,000?

A. That is correct.

Q. And then——

The Court: That is about \$900,000 less than the Basis 2?

Mr. Adams: No, you see the Basis 2 that we are comparing our figure with is the one given for the Western Pacific Railroad Company, the first one on the righthand column.

Mr. Phleger: \$772,000.

Mr. Adams: No, \$15,726,000 if I read that rightly.

Mr. Phleger: No.

Mr. Adams: I beg your pardon, \$15,572,000.

Mr. Phleger: That is correct.

Mr. Adams: Yes.

Mr. Phleger: It is the top figure, your Honor, opposite the "Western Pacific Railroad Company," \$15,572,630, of Mr. Cockburn, or I mean, of Mr. Buchanan.

(Testimony of James L. Cockburn, Jr.)

The Court: I see.

Mr. Phleger: Against \$14,800,000 of the witness.

The Court: Besides a difference of about \$700,000.

The Witness: About \$770,000.

The Court: The difference between the result of Basis 2 and your Exhibit 41? [1460]

The Witness: That is correct.

Q. (By Mr. Adams): Now do you believe that Basis 2 makes proper allowance for the carry-overs?

A. No, I do not.

Q. Will you explain that, please?

The Court: You mean they haven't calculated the carry-overs correctly in this schedule?

The Witness: That is correct.

The Court: We will take a brief recess at this time.

(Recess.)

Q. (By Mr. Adams): Mr. Cockburn, I wish you would turn to the third page of Plaintiff's Exhibit 80, Basis 3. Have you examined that basis and checked it? A. I have.

Q. Do you think that the tax liability shown on Basis 3 are the amounts of the taxes which would have been payable on a consolidated return basis for the years '42 and '43 and the first four months of '44 if the stock loss of the Western Pacific Railroad Corporation had been disallowed in toto?

A. I do not.

Q. And would you please state what corrections

(Testimony of James L. Cockburn, Jr.)

should be made in order to arrive at a correct computation on that basis?

A. I would make adjustments for accelerated amortization, United States Government freight cut-backs, and refunds, and United States Government reparations claims. [1461]

Mr. Phleger: Well, now I object to that response and move that it go out.

The Court: I can't see the point of that answer at all.

Mr. Adams: Well, your Honor, the Basis 3, according to its own title, purports to be "Federal Income Taxes and Excess Profits Taxes on Basis of Consolidated Returns as Filed, but Excluding Corporation's Stock Loss."

The Court: Yes, but all Mr. Buchanan did was to take the stock loss out of it, and on the same information that was in the return, make this calculation. Now I don't think the witness is intending to say that on that basis, this basis is incorrect.

Mr. Adams: Well, I take it that the witness being an accountant, he is permitted to say what approach he would make to the same question that is indicated at the top.

The Court: Well, what you are asking him now to testify is that if he had filed the consolidated return for this corporation at the time it was filed, and he wasn't including the stock loss in it, that he would have included something else in it.

Mr. Adams: That is right.

(Testimony of James L. Cockburn, Jr.)

The Court: That is what you are asking him to say.

Mr. Phleger: Well, he is not even saying that, your Honor, because the reparations didn't occur until years later. Cut-backs, too. [1462]

Mr. Adams: It didn't occur to me that this answer could be objectionable, since it is an expert's statement of his differences, and that is all it is.

The Court: Yes, but this Basis 3 was offered in connection with testimony of Mr. Buchanan, only to show that the calculation of the taxes on the basis of the return as it was filed, if the stock loss would have been excluded, would have shown this result. Now that is all the witness testified to. That is all Mr. Buchanan testified to, according to my recollection.

Mr. Adams: Yes.

The Court: Now with that in mind, Mr. Cockburn, is there any inaccuracy in these figures as far as you know?

The Witness: Schedule 3, Basis 3—

Mr. Adams: Just a moment. Pardon me the interruption.

The Court: Well, all right, I will withdraw the question.

Mr. Adams: Well, I think I can put the question this way.

Q. Mr. Cockburn, you notice that Basis 3 carries a notation, "Corporation's excess profits credits for 1944 prorated."

A. That is correct.

(Testimony of James L. Cockburn, Jr.)

Q. And is it your understanding—you discussed this with Mr. Buchanan—that that proration was on one-third of the corporation's excess profits credit for the year? A. That is correct.

Q. He used that in making his computation?

A. That is correct.

Q. Now if you assume that you are going to make the computations on Basis 3 and only give one-third of the corporation's excess profits credit for 1944, would you then find any error in the computations themselves?

A. Yes, I would.

Q. And what error would you find there?

A. I do not agree with the portion of the computation whereby two-thirds of the excess profits credit—

Q. No, Mr. Cockburn, you didn't understand my question. My question was, If you assume that you are making the computation on the basis of a one-third proration, then would you find that the computations themselves were inaccurate?

A. No, I would not.

Mr. Adams: That gets at what your Honor had in mind, I take it?

The Court: Yes.

Mr. Adams: And now at this time, your Honor, I would like to offer a chart. It is a reduced picture of the big picture that is over there on the side wall (indicating). It is a replica in smaller form and easier of reference. This chart is a chart

(Testimony of James L. Cockburn, Jr.)

that we, the counsel, prepared, like the charts over on the righthand side of the court room as I face your Honor (indicating). It is a pictorial representation, all of the figures in which and all of the data in which is taken from that [1464] exhibit you have in your hand, Defendant's Exhibit 40.

The Court: All right.

Mr. Adams: I offer this as Defendant's Exhibit——

The Court: As a pictorial representation?

Mr. Adams: Simply as a lawyer's representation of what is contained in the report.

But I should say one further word about it. In the report which your Honor has before you, Defendant's Exhibit 40, there is stated, particularly in note 2 to Schedule 1 to that report, a full statement with regard to a special transaction between the plaintiff corporation and the Utah Fuel Company. Your Honor will see there is quite an elaborate statement in note 2 about that. Now this chart does not take that special transaction into account in any way. It leaves it out.

I might explain, by way of further elucidation, why that is left out. Neither the Western Pacific Railroad Company nor any of its subsidiaries were participants in the special transaction between the plaintiff corporation and the Utah Fuel Company.

Mr. Clark: You will concede, though, Mr. Adams, won't you, that the Utah Fuel Company was a member, a subsidiary and member of the affili-

(Testimony of James L. Cockburn, Jr.)

ated group at that time, namely, up to the year 1924?

Mr. Adams: I make all the concessions which are stated in note 2 which includes the statement Mr. Clark just made. All the facts are fully stated in that report, and I expect both counsel can talk about them to the extent they want to. [1465]

With that explanation, your Honor, I offer this as a lawyer's chart for your Honor's convenience, and not as proving anything additional to what is proved in Defendant's Exhibit 40.

Mr. Phleger: As we objected to 40, I would like to record the same objection to this.

The Court: On the incompetency of the material itself?

Mr. Phleger: Right.

The Court: Well, I think we have sufficiently covered that ground, so that the record is clear. It may be marked.

(Chart referred to was then received in evidence and marked Defendant's Exhibit 48.)

Mr. Adams: No further questions, your Honor.

Cross-Examination

By Mr. Phleger:

Q. Mr. Cockburn, referring to your computations on Defendant's 41, as to what the tax would be eliminating the deductions as noted at the bottom, I understand your figures was \$14,800,000?

A. Is that Exhibit D? I do not have it.

(Testimony of James L. Cockburn, Jr.)

Q. D, yes. And I understand also that you have compared with Basis 2 of Plaintiff's 80, the figure, being \$15,572,630, on Basis 2?

A. That is correct.

Q. Now will you state exactly what the difference between your figure and Mr. Buchanan's figure is?

A. Well, we only made approximate computations, and computed [1466] that the approximate difference was \$14,800,000, and the figures I testified to were the computations of the liability of our Schedule D, but not claiming any of the deductions as stated in footnote 1.

Q. Then let me ask this question: Is Mr. Buchanan's computation, Basis 2, opposite the Western Pacific Railroad Company, \$15,572,630, incorrect as a matter of computation upon the basis on which he computed Basis 2?

Mr. Adams: Well, your Honor, is it clear what is meant when reference is made to the basis on which Mr. Buchanan computed?

Mr. Phleger: Yes, it is stated in the caption.

Mr. Adams: Well, that is just the point; I don't think the caption does state it. For example, Mr. Buchanan did not restore the inter-company interest deductions. He did so testify. I don't think the witness who is now on the stand was here at the time Mr. Buchanan so testified.

Mr. Phleger: I want to have a comparison, a real comparison, between Basis 2, according to Mr.

(Testimony of James L. Cockburn, Jr.)

Buchanan and his computation, and according to this witness' computation.

A. The basic differences between the two computations, without being able to give exact tax amounts caused by the different deduction amounts, the deductions for inter-company interest, is the repositioning of the Deep Creek loss from 1940 to 1939, the disallowance of deduction or not claiming a deduction of [1467] approximately \$169,000 for reorganization expense, which was claimed in the return for 1940—differences in the net operating loss carry-overs and excess profits credit carry-over as a result of the different assumptions, and certain minor differences, errors, in computations, which I think could be corrected.

Q. Well, other than for those changes which you have just recited, your figure would be approximately the same as Mr. Buchanan's figures?

A. That is correct.

Q. Now the computation on Defendant's 41 and on Plaintiff's Exhibit 80, Basis 2, is as a matter of fact, not in accordance with the regulations, is it?

Mr. Adams: Now just one moment; your Honor, if your Honor please, I object to the question. The question assumes something that is not stated in the question. Both those computations have been made upon the assumption of separate returns being filed.

Mr. Phleger: No, that isn't my point, Mr. Adams.

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: It is my point in objecting to the question.

Mr. MacKinnon: I object to it upon the ground that it calls for the witness' expression on a question of law. That is for your Honor to decide.

Mr. Phleger: The purpose of my question, your Honor, was to point out that the exhibit prepared by this witness and introduced by the defendant assumes a fact that is contrary to existing [1468] law, namely, that you cannot, having filed consolidated returns in one period, file separate returns in a later period and use the carry-forwards and carry-backs, contrary to regulation 110, Section 33.31 (e) and (f). Isn't that correct?

Mr. Adams: Your Honor, I object to the question and I direct your Honor's attention to the caption of the schedule itself. And further I object on the ground the question asked is a question of law, the same objections having been addressed to my interrogation of this witness and sustained.

The Court: I think it is needless to pursue this particular line of inquiry as a matter of evidence. It is very obvious that your accountant is of the view, probably supported by some legal advice, that these carry-overs cannot properly be included, but nevertheless he has put them in anyhow and to make another basis of calculation, and the witness on the witness stand may or may not have the contrary view, but it is really of no importance because that question is a question of law, isn't it?

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: I think I have not made myself clear at all. What I am trying to point out to this witness—and the fact that I have not made it plain justifies the question—is that both this witness, in Defendant's Exhibit 41, and Mr. Buchanan in Basis 2, have both made the computation, although it is not permitted by the regulation which is cited as regulation 110, so that they are on the same basis. [1469]

The Court: Except that this witness may have a different view. He may say that it is permitted under that regulation. I do not know.

Mr. MacKinnon: If your Honor please, I do not think it makes any difference what he says because you are going to determine that question.

Mr. Phleger: I want to point out that the basis of the two exhibits is the same.

The Court: I think that is obvious without the witness' testimony.

Mr. Adams: With the variances between the figures which the witness has testified to.

Q. (By Mr. Phleger): Did you examine the books of the defendant corporation as to the manner in which its amortization claims were in fact handled?

A. Do you refer there to subsequent treatment of those claims?

Q. No, the actual way in which they were treated.

A. The treatment of the amortization is dis-

(Testimony of James L. Cockburn, Jr.)

closed in the returns which we inspected and from which we made our computation.

Q. So you did then examine the actual treatment made of the amortization claims as shown by the tax returns? A. That is correct.

Q. It is a fact, is it not, that this company in 1945 received credits of \$4,998,648.28 on account of amortization claims?

A. Our inspection related to the period ending April 30, 1944. [1470]

Q. You did not know then that those claims had been allowed? A. No, sir.

Q. You just learned about them from me now, is that right?

Mr. Adams: You mean as to the amount or the fact?

Mr. Phleger: The fact and the amount, both.

A. Yes, sir.

Q. (By Mr. Phleger): With respect to the United States Government freight cut-backs and refunds, did you make any investigation at all, either you or anyone acting for you, of the actual facts with respect to the payments of refunds or the application of cut-backs? A. No, sir.

Q. Do you know whether or not the actual figures which you have used in your estimate here have or have not been used as the basis for reduction of income tax? A. I do not.

Q. Your assumption is based upon the proposition that in years subsequent to 1942 and 1943

(Testimony of James L. Cockburn, Jr.)

and the first four months of 1944 that the company was in fact charged, either paid out or did not collect on account of these amounts, isn't that right? A. That is incorrect.

Q. What was your assumption?

A. The assumption was the Western Pacific Railroad Company could have claimed these adjustments by the government arising out of cut-backs or refunds in subsequent years, could have been [1471] claimed as a deduction in the years 1942, 1943, and the first four months of 1944.

Q. But that assumption is in turn predicated upon the proposition that those amounts were in fact paid out in later years, is that not true?

A. Paid out or withheld?

Q. Yes. A. That is correct.

Q. And did you take into consideration when paid out or withheld in later years, that the company received the income tax benefit of that treatment? A. I did not. [1472]

Q. Did you give any consideration to that at all in this matter of this computation?

A. I did not.

Q. Do you know whether or not the company paid excess profits taxes in the last eight months of 1944? A. I believe they did.

Q. Did they pay excess profits taxes in 1945?

A. I believe they did.

Q. Did they pay excess profits taxes in 1946?

A. They did not.

(Testimony of James L. Cockburn, Jr.)

Q. There weren't any excess profits taxes?

A. That is correct.

Q. Did you make any investigation of the partial debt loss on the Sacramento Northern Railway notes and advances?

A. Yes, we made an analysis of the advances, times and amounts of advances to the company, from the records of the company, which shows the dates and the amounts that were advanced, and the dates of refunds or repayments by the Sacramento Northern to the Western Pacific Railroad Company.

Q. Do you have that computation?

A. Yes, I believe we have those papers here.

Q. I would like to have them.

Mr. Adams: Just one minute. Let us get clear what you are speaking of. Will you ask the witness, please, so we can get an identification of what you would like to have? I did [1473] the same thing with Mr. Buchanan.

Mr. Phleger: It is perfectly clear here. He said he made an investigation of time and amounts of advances made by the Western Pacific Railroad Company to the Sacramento Northern and also the dates and amounts of repayments.

Mr. Adams: Right.

Mr. Phleger: And I asked him for them.

Mr. Adams: Yes. Are you now asking this witness to prepare a new paper, or are you asking him for some paper that he has got?

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: I am asking him for the paper he just testified——

Mr. Adams: He did not say he had a paper. That is my point. I would like to get an identification of what you are talking about.

Q. (By Mr. Phleger): Do you have a paper which shows the advances and repayments?

A. We have certain working papers showing the listing of the advances and the repayments.

Q. And you will be glad to furnish them to me, will you?

Mr. Adams: Just a minute. I object to that. The witness has his working papers, and I take it we are willing, and have always been willing, that they may be inspected, but that they should be furnished to opposing counsel I do not think is proper, and I did not make that request of your expert witness. [1474]

Mr. Phleger: I do not see the difference.

Q. Do you have them here? Suppose you let me look at them.

A. I believe we have them with us.

(A document was handed to Mr. Phleger.)

Mr. Adams: I would like to have the record in some way indicate the nature of the work sheet that has just been exhibited to opposing counsel. If opposing counsel will be good enough to designate the approximate number of sheets or something in the way of showing the substance of the papers he is now looking at, I would appreciate it.

(Testimony of James L. Cockburn, Jr.)

Mr. Phleger: May it please your Honor, I do not want to take up the time of the Court while I examine this. May it be understood that at the noon recess I will have access to these working papers and have an opportunity to look over them?

Mr. Adams: Certainly. May I ask that some description, counsel, be now placed on the record?

The Court: Let the witness testify what he has produced. Mr. Phleger probably cannot tell at a glance what it is.

Mr. Adams: A question can be addressed to him for response after he has a chance to inspect them.

Mr. Phleger: Let us do what you did, Mr. Adams. Let us request the clerk now mark with an identifying mark every working paper that this witness used in preparation for the testimony that he has just given.

Mr. Adams: I will be very glad to do that. The arrangement, [1475] however, that we made relieved the clerk of that task and we accomplished it privately.

Mr. Phleger: All right. Will you mark them for me?

Mr. Adams: I think that since we marked yours, we might ask you perhaps to indulge the same practice.

Mr. Phleger: I will trust you to mark them.

Mr. Adams: I would certainly trust you to mark them, Mr. Phleger.

Q. (By Mr. Phleger): Do you know whether any advances were made to the Sacramento Northern in 1942?

(Testimony of James L. Cockburn, Jr.)

Mr. Adams: May the witness have his working papers in his hands?

The Witness: If I may refresh my memory from the working papers—Yes, there were reimbursements—

Q. (By Mr. Phleger): I am asking about advances.

Mr. Adams: Will you read the question, please?

(Question read.)

A. Yes, there were.

Q. (By Mr. Phleger): In what amount?

A. \$242,000.

Q. What were they represented by?

A. Cash advances.

Q. Notes? A. Cash advances.

Q. Were there any advances made during the year 1943? [1476] A. No, there were not.

Q. Were there any in the first four months of 1944? A. No, there were not.

Q. Were there any in the last eight months of 1944? A. Yes, there were.

Q. How much? A. \$220,000.

Q. How much were made in the year 1945?

A. No advances made in 1945.

Q. 1946? A. \$370,000.

Q. 1947? A. \$700,000.

Mr. Phleger: That is all I have for the moment of this witness. I would like the noon hour to examine these and other documents and maybe I won't have any further questions.

The Court: Have you got some short witness, or would you prefer to recess?

Mr. Adams: I think I have one short witness I can call. I would like to call Mr. Droit. I have about one question to put to him. I have two short witnesses, your Honor. I will call Mr. Droit and maybe I can call Mr. Mintzer and excuse them both. [1477]

CLARENCE L. DROIT

called on behalf of the defendants; sworn.

The Clerk: Will you state your name, please?

The Witness: Clarence L. Droit.

Direct Examination

By Mr. Adams:

Q. Please state your business and business address.

A. 526 Mission Street, San Francisco.

Q. And you are the secretary of the Western Pacific Railroad Company? A. I am.

Q. And you have held that office since when, Mr. Droit? A. August, 1937.

Q. Mr. Droit, did I ask you to check the records and see whether or not during 1943, 1944 and 1945 there was sent out from your office to the firm of Goodbody & Company in New York any copies of the annual reports for 1943 and 1944?

A. You did.

Q. What did you ascertain with regard to that?

Mr. Clark: Just a minute. I will object to that

(Testimony of Clarence L. Droit.)

upon the ground it is incompetent, irrelevant and immaterial.

Mr. Adams: The sole point of this, your Honor, is to prove notice to the intervener Offerman, who was associated with Goodbody, of a copy of one of those annual reports which contained all the data about this tax matter. [1478]

Mr. Levy: He is an employee of Goodbody.

Mr. Adams: He is just what was described, a customers' broker in Goodbody & Company.

Mr. Levy: He was an employee.

Mr. Clark: We will object to it, your Honor, on the ground it is incompetent, irrelevant and immaterial.

The Court: Overruled.

Q. (By Mr. Adams): The question was, What did you ascertain in that regard?

A. Well, I ascertained that Goodbody & Company were stockholders and appeared on the stock list, and they were mailed a notice of the annual meeting by the Central Hanover Bank and Trust Company, which also contained proxy material and a copy of the annual report.

Q. For what year?

A. The year 1944.

Q. And approximately when was that proxy material mailed? A. June 1, 1945.

Mr. Adams: No further questions, your Honor.

Mr. Clark: Nothing from us, your Honor.

The Court: That is all.

LUCIO M. MINTZER

called on behalf of the defendants; sworn.

The Clerk: State your name to the Court, please. [1479]

The Witness: Lucio M. Mintzer.

Direct Examination

By Mr. Adams:

Q. Mr. Mintzer, do you have with you the schedule which I expect to produce and identify?

A. No, I do not have it with me.

Q. I have it.

I offer as Defendants' Exhibit 49 for Identification a statistical statement on two sheets entitled in this case, "Record of Weekly Sales of Preferred and Common Shares of the Western Pacific Railroad Company on New York Stock Exchange January 1, 1945, to October 31, 1946, as published in 'The Commercial and Financial Chronicle' of New York," and these two sheets show, your Honor, the volume of trading by weeks in the railroad company's preferred and common stock and the weekly range of prices in that stock, the period being from the time the reorganized company took over on the 1st of January, 1945, to the approximate time of the commencement of this litigation here in San Francisco; but since it is set out by weekly dates, it will also show the figures up to the time the stockholders' suit was begun in New York. The purpose of this showing, like the showing with re-

(Testimony of Lucio M. Mintzer.)

spect to the conversion of the income bonds, is to show the change of position that took place in respect of these stock holdings between the time the reorganized company started operating and the time this claim was first asserted. And I am reminded that I have not gone through the [1480] proper formalities in asking Mr. Mintzer to please state his business and business address.

The Witness: I am employed by the firm of McCutcheon, Thomas, Matthew, Griffiths & Greene.

Q. (By Mr. Adams): Mr. Mintzer, it was at our request that you made this study?

A. It was.

Q. And this is your work? A. It is.

Q. Would you state generally the nature of your business as at present and for some years past?

A. I have handled investments and made recommendations for investments to the partners in the firm with respect to clients' accounts, trusts, and so on.

Q. Is this to the best of your knowledge a correct statement of the record of weekly sales of preferred and common shares of Western Pacific Railroad Company, as identified in the title for the period therein stated? A. Yes, it is.

Mr. Adams: I offer it, your Honor, as Defendants' Exhibit 49.

Mr. Phleger: Your Honor, I object to the receipt of the exhibit upon the ground it is incompetent, irrelevant and immaterial, and particularly

because it shows the prices at which these shares were bought and sold, and seems to me [1481] entirely immaterial, if not misleading. I am willing to stipulate, although I do not even think it is material, that those stocks were traded on in the New York stock exchange during this period.

The Court: The reorganized company?

Mr. Phleger: That is right.

Mr. Adams: Yes. Your Honor, we consider the prices are significant for the reason that in the reorganization plan those stocks were created, and we consider it a part of the equity position before this Court to show, as this exhibit shows, what relation to that value the market value of the stock had from year to year and from time to time prior to the time this claim was first made.

The Court: I do not see what the materiality of that is. What would you say is the materiality? It sometimes happens something you buy is not as good as you thought it was.

Mr. Adams: This much, your Honor: We offered a schedule the other day that we prepared showing that one of the secured creditors in the reorganization was not paid to the extent of some three and a half million dollars. Now, the schedule shows that that stock, which was received by that claimant under the plan, was received at a price of \$62 a share. If this schedule does nothing else in respect of prices, it discloses as a definite fact that at no time thereafter could it possibly be said that that claimant had been paid one

way or another, even in [1482] a loose sense, by an increase in the market price over or above that \$62 figure.

The Court: Well, now, Mr. Adams, suppose I go out and buy some stock in a corporation on the stock exchange, and after I buy it I find out that somebody has some claim which he is asserting against the railroad company or a corporation, for instance, that affects the value of the stock; now, what bearing has my purchase or sale of that stock got on the rights of the parties who were involved in the claim that is presented here? I don't see the connection there, unless you wanted to show that everybody that bought stock in this corporation on the New York stock exchange made a very thorough investigation of the stock to find out whether or not there was a claim of this nature pending before they bought it—which would, of course, be contrary to everything that the American people do. With that assumption, why, then there might be some possibility of showing reliance, and hence a change of position. But of course you couldn't have a change of position without reliance.

Mr. Adams: Well, your Honor would bear in mind that during the period here covered by this report, for example, the annual report of the Railroad Company for '44 was published, contained a full statement about the tax matter, stating that there was this reserve fund, stating that it was there to respond to possible tax liability to the Gov-

ernment—and [1483] nothing was said in that report about this claim, because it hadn't been heard of.

The Court: Well, Mr. Phleger, you don't object to the accuracy of this computation, but merely to the relevancy?

Mr. Phleger: That is right.

Mr. Clark: And we object to the relevancy.

The Court: It may be marked for identification, and I will sustain the objection on the ground that it is incompetent, irrelevant and immaterial.

(The document referred to was marked Defendants' Exhibit 49 for Identification.)

* * *

JAMES L. COCKBURN, JR.

resumed.

Mr. Phleger: I have no questions at this time.

Mr. Clark: We have none, your Honor.

The Court: Any further questions, Mr. Adams?

Mr. Adams: One question, if your Honor please.

Maybe there will be two, but it will be the part of one, if I make it two.

The Court: Very well.

Redirect Examination

By Mr. Adams:

Q. Mr. Cockburn, you recall this morning you gave the Court a figure, \$14,800,000 as representing the amount of total tax liability of the rail-

(Testimony of James L. Cockburn, Jr.)

road company on the assumption of a separate return basis, on the assumptions in your Schedule D marked Defendant's Exhibit 41, if the deductions were disallowed. Do you recall that?

A. That is correct.

Q. And you recall also that you stated the difference between that figure and the amount shown on Basis 2 of Plaintiff's 80 was approximately \$770,000?

A. That is correct.

Q. Now you mentioned some factors that you said were responsible [1485] for this difference, and one of them was, was it not, the difference in the computation of the carry-overs?

A. That is correct.

Q. Now I would like you, in order to clarify the record, to explain the difference between the method you used in that computation and the method Mr. Buchanan used in his computation on Basis 2; and I might ask you preliminarily, have you checked Mr. Buchanan's computations with him?

A. I have.

Q. You have seen his working papers?

A. I have.

Q. Do you believe you are able to state the basis on which his computation was made as well as that upon which yours was made?

A. I do.

Q. Will you please then state what those two bases were, so that the Court may see the difference?

(Testimony of James L. Cockburn, Jr.)

A. The basis of Mr. Buchanan's computations, as stated in his heading to Basis 2, assumes that the Western Pacific Railroad Corporation and affiliated companies had filed consolidated returns up to and including December 31, 1941. And the net operating loss carry-over and excess profits carry-overs included in his computations for 1942, '43 and the first four months of '44 are taken from the consolidated returns filed, particularly, I think, from the 1942 return, where the carry-over [1486] from 1941 is shown. Our net operating loss carry-overs and excess profits credit carry-overs used in preparation of Exhibit D——

Q. That is Defendant's 41, is it not?

A. That is Defendant's 41. ——assumed that separate returns were filed from '39 onward, and that therefore the excess profit carry-over and the net operating loss carry-over years in our computation are those carry-overs which a company would have had going into 1942 had it filed separate returns prior to that time.

Mr. Adams: I have no further questions, your Honor.

Mr. Phleger: No questions.

Mr. Clark: No questions.

The Court: That is all.

(Witness excused.)

Mr. Adams: Now at this time, your Honor, in connection with the evidence just produced, I would like to offer as Defendant's Exhibit 50 a photo-

static copy of what I heretofore referred to as the ruling of the Commissioner of Internal Revenue in the Santa Fe case. This is a photostatic copy of a letter I have given to counsel. My reason for putting it into the record is simply that I am not certain whether or not it is a public-had ruling. The materiality of the ruling would be evident upon examining it. It is a ruling under which provision is made for the cut-backs to be taken into the accounts in the years in [1487] which the transportation took place, for income tax purposes.

Mr. Phleger: We do not object to its competency, but we consider it irrelevant and immaterial.

The Court: I will admit it.

(Photostatic copy of ruling referred to above was thereupon received in evidence and marked Defendant's Exhibit 50.)

WILLIAM A. SUTHERLAND

called as a witness on behalf of the defendant;
sworn.

The Clerk: State your name to the Court.

A. William A. Sutherland.

Direct Examination

By Mr. Adams:

Q. What is your address, Mr. Sutherland?

A. Marine Building, Washington, D. C.

Q. What is your occupation?

(Testimony of William A. Sutherland.)

A. Lawyer.

Mr. Adams: If your Honor please, for the sake of brevity may I ask leading questions in regard to the qualifications of the witness?

The Court: Very well.

Mr. Adams: Mr. Sutherland, you are a member of the firm of Sutherland, Tuttle and Brennan having offices in Washington and in Atlanta, Georgia?

A. Yes, sir.

Q. You did your first year of college work at Florida and [1488] received your A.B. from the University of Virginia, your M.A. from the University of Wisconsin, and you graduated from the Harvard Law School in 1917 with an LL.B. degree?

A. Yes.

Q. Of what bars are you a member?

A. I am a member of the Bar of Georgia, the District of Columbia, the Supreme Court of the United States, the Court of Claims, the District Courts in Georgia, the Fourth, Fifth and Sixth Circuit Courts of Appeal, and I think the Second.

Q. And you are a member of the American Bar Association, the Georgia Bar Association, the Atlanta Bar Association, and the Atlanta Lawyers' Club?

A. Yes.

Q. You were admitted to practice before the Treasury Department in 1923?

A. Yes.

Q. What was your first position after you left law school?

A. I was secretary to Mr. Justice Brandeis

(Testimony of William A. Sutherland.)
of United States Supreme Court for his second and third years on the court.

Q. Were you at any time associated with the Federal Trade Commission, and if so, in what capacity?

A. Yes, when I left Justice Brandeis in 1919 I was with the Federal Trade Commission until the end of 1920 as an attorney examiner.

Q. And you were general solicitor and head of the Law Department [1489] of the Tennessee Valley Authority for a few months in 1933 and 1934?

A. Yes, sir. I did not give up my practice at that time.

Q. You have been engaged in private practice since 1921? A. Yes.

Q. Your firm has had offices in Washington since 1937? A. Yes.

Q. Have you specialized in any particular field of law practice?

A. I have specialized in federal taxes largely since 1923.

Q. Mr. Sutherland, in your opinion would a lawyer engaged to advise on the tax problems of an affiliated group of corporations be expected to advise one of the members of the group, which member had substantial losses, that it had the right, by refusing to join in a consolidated return, to deny to the income corporations in the group the use of the loss deduction to offset the taxable income of the group as a whole, where such member would

(Testimony of William A. Sutherland.)

suffer no tax disadvantage from joinder in the consolidated returns, and where the consolidated return was to be filed after the member sustaining the loss had severed all affiliation with the other members of the affiliated group?

Mr. Phleger: May it please the Court, I object to the question on the ground it is incompetent, irrelevant and immaterial and hearsay. I assume that this is supposed to be some testimony by an expert upon an issue which, I take it, would be either of law or of fact. If of law, I do not think it is an [1490] appropriate matter for expert testimony, and if a fact, it simply calls for the conclusion of this witness. It attempts to usurp the function of the court.

Mr. Adams: The question is directed, your Honor, to what we understand to be an issue in the case as evidenced by questions asked yesterday of one of the lawyers who handled tax matters, whether or not he expressly advised a member of the affiliated group that it had a right to file a separate return. Now, this question is addressed concededly to a well-qualified lawyer engaged in tax practice, and asks him whether in his opinion under the stated assumed set of facts the question that I addressed, which we regard as responsive to that particular issue, and as a question of fact upon which a qualified expert can answer, a question posed upon an assumed set of facts.

The Court: If it is a question that is posed on

(Testimony of William A. Sutherland.)

an assumed state of facts, it is not a question of fact.

Mr. Adams: The assumptions contained in the question, your Honor, we believe are all of the assumptions required to be made upon the record in this case.

The Court: Then it is just expert testimony.

Mr. Adams: It is undoubtedly the testimony of an expert witness that we are offering upon a hypothetical question.

The Court: I never heard of a case in which the lawyer could testify as an expert witness as to any issues in the case, except it be on some special subject, such as foreign law, or [1491] matters with which he might be acquainted and of which the Court might not be acquainted. If we admitted this kind of testimony it would result in each side getting the best lawyers they could think of to come in and tell the Court how to decide the case. It does not seem to me to have a proper place in the trial of a lawsuit.

Mr. Adams: Your Honor, I do not wish to argue this at length, but merely state what I perceive to be the point of the question.

The Court: I understand exactly what you are trying to bring out, but the question is, can you bring in a lawyer to testify as an expert that what was done was properly done? If you can do that in this case, you can do it in any case.

Mr. Adams: Your Honor will bear in mind this

(Testimony of William A. Sutherland.)

question is directed to the conduct of a lawyer; it is not the ultimate issue in the case.

The Court: If it is not an issue in the case, then of course it is not competent.

Mr. Adams: I said to the ultimate issue. I think, as I understand it, there is some contention here, because of the questions asked yesterday, whether the lawyer did or did not give certain advice.

The Court: Suppose the witness testifies and answers your question, and I would be satisfied from all the facts and circumstances of the case that a different result should follow. [1492] Would there arise by virtue of that a conflict that would make a record so that a higher court reviewing it could say the court was making a finding with respect to conflicting presentations of an issue?

Mr. Adams: I would think that as in any case of expert testimony, the testimony is before the court to be weighed and considered as any other testimony. Certainly I do not understand in any case, except where there is no conflict in the testimony, a court is ever bound, certainly with regard to an issue of this sort.

The Court: Even if it was offered as expert testimony, wouldn't the witness have to qualify that he was familiar with all the material facts presented in connection with the matter?

Mr. Adams: We consider that this question embraces all the material facts requisite to an answer to the question.

(Testimony of William A. Sutherland.)

Mr. Clark: I might point out to your Honor that it does not embrace one important fact, namely, that there was an economic divorcement some years prior to the termination of the affiliation.

The Court: Mr. Adams, do you have with you any authority which sustains the right to present as competent the testimony of a lawyer with respect to any legal issues in the case, except where it involves some special subject such as foreign law or, in some cases, it is allowed in tax controversies?

Mr. Adams: If your Honor will allow me a moment, I will be [1493] sure of an answer.

The Court: I want to be sure there isn't something lurking in this that I do not know about.

Mr. Adams: We have no authorities to cite on the specific question.

The Court: I think the testimony is incompetent. I will sustain the objection.

Mr. Adams: I will ask one further question.

Q. Mr. Sutherland, in all your experience have you ever heard, prior to hearing the claim asserted in the proceeding now in this court, of a claim by a member of the group of corporations which filed consolidated tax returns to be paid anything by any other corporation in the group, any consideration for the tax advantage resulting from the loss sustained by the claiming member of the group? [1494]

Mr. Phleger: May it please the Court, I object to that question on the ground that it is incompetent, irrelevant and immaterial, calls for the con-

(Testimony of William A. Sutherland.)

clusion of this witness, and is another attempt to usurp the function of the Court.

Mr. Adams: Stating very briefly my answer, because this question is much like that your Honor ruled on with respect to the actors, it is our object to prove as a fact from an experienced counsel in the tax field that this claim had never been heard of by him. We think this is material to the issues in this case and is part of the character of this claim, as a later afterthought. We regard it as a material fact in the case, and this is a part of that proof. It is also responsive to any suggestions that any of the lawyers whose work was involved in handling the tax matter was in any respect other than the work of competent and conscientious lawyers, because obviously if the claim now asserted is one which was beyond the general purview of tax lawyers, then no criticism can be addressed to a lawyer who had not heard of it. Those are the purposes.

The Court: I will sustain the objection. Let me say to you, Mr. Adams, that you can make the same argument on the same subject matter in your briefs, and I, without meaning any disrespect to the witness, would listen to it perhaps even more attentively as coming from learned counsel who have practiced here, and for whom I have respect; I might [1495] consider the argument coming from the attorneys in the case as having more weight with me, since you are familiar with this case, than the testimony of an expert.

(Testimony of William A. Sutherland.)

Mr. Adams: May I say, your Honor——

The Court: That may mean something with regard to losing out on this point, I don't know.

Mr. Adams: May I say, with all due respect, that we would offer to prove that the questions, if the answers should be allowed, would be answered in the negative.

The Court: I beg pardon?

Mr. Adams: I would offer to prove that if your Honor would allow these questions, the answers to each of them would be in the negative.

The Court: Let the record so show.

Mr. Adams: And may I also state for the record that we have had very happy associations with Mr. Sutherland and also with Mr. George Maurice Morris, who have considered some of these problems with us. They have spent considerable time on the case. We would address the same questions to Mr. Morris. May I state briefly what his qualifications would be?

The Court: Very well.

Mr. Adams: Mr. Morris is a member of the firm of Morris, Kix Miller & Baar of Washington, D. C., having offices in Washington and Chicago. He is a graduate of Dartmouth College in 1911, and a graduate of the law school of the University of Chicago in 1916, with a degree of Doctor of Jurisprudence, [1496] and was admitted to practice in Illinois and the District of Columbia, and has practiced before the Supreme Court, several

(Testimony of William A. Sutherland.)

of the United States circuit courts of appeal, the Tax Court, Court of Claims, State and Federal courts of Illinois and the courts of the District of Columbia, and is admitted before the Treasury Department and was formally admitted in 1922.

Mr. Morris is a member of the American Bar Association, the Bar Association of the District of Columbia, the Illinois State Bar Association and honorary member of a number of other bar associations, and currently an official of the Interamerican Bar Association and the International Bar Association. He was Chairman of the Executive Committee of the Interamerican Bar Association and speaker of the House of Deputies of the International Bar Association. Now, Mr. Morris has specialized largely in the field of taxation and administrative law, advising taxpayers and representing them before administrative agencies and the courts. May I take the pleasure of introducing Mr. Morris to the Court?

(Mr. Morris then arose.)

Mr. Adams: I take pleasure in presenting Mr. George Maurice Morris, whose qualifications I have just read, and in stating that offer to prove that Mr. Morris, as well as Mr. Sutherland, would answer these two questions in the negative if your Honor permitted them to be answered.

The Court: Very well. Let the record so show. That is all.

(Witness excused.)

The Court: I don't want it to appear in the record, because sometimes when we read these things over afterwards, in the cold record they read pretty badly, and they are not intended that way. I have no criticism of the qualifications of any of the lawyers who come from afar to testify in these cases. I want to say, however, that I do not think we have to take a back seat out here in the West so far as qualifications of lawyers to testify goes. I know I held court in New York for a couple of months, and I found that our bar out here in the West did not have to take a back seat to the bar in the East. I think they are on a par, one with the other. That is why I said that the argument could be made on the same subject matter concerning which expert testimony was proffered to be made, as well as by the attorneys in this case, for whom the Court has considerable respect.

Mr. Adams: If your Honor please, I neglected to say, and would like to cure the neglect, that Mr. Morris is, as well, past president of the American Bar Association.

The Court: Very well.

Mr. Adams: If your Honor please, with the consent of counsel, in response to an open question upon the examination of Mr. Elsey, I will state that the amount, principal amount, of general mortgage $4\frac{1}{2}$ per cent income bonds which had been converted at June 29, 1946, was \$4,489,300, being converted into stock in the ratio of 20 shares of stock per \$1,000 bond. I would like the record to

show that Judge Sloss, whose appearance in the reorganization proceeding as attorney for the plaintiff corporation upon its intervention, continued to represent the plaintiff corporation in the reorganization proceeding while that proceeding remained pending, and until it was completed.

Mr. Clark: Well, your Honor, in the first place, we think it is incompetent, irrelevant and immaterial, but we don't think we can give the concession without Judge Sloss' own testimony, which was taken on deposition, in which he testified to the limitation of his representation of the plaintiff corporation, as being solely having to do with presenting its position under the plan. Now, we have that testimony. If counsel thinks it is material it can easily be read into the record. We examined Judge Sloss on it.

Mr. Adams: I told Mr. Clark I would be happy to do it that way, and I am perfectly willing to do that, to read it into the record.

Mr. Phleger: Well, let's stipulate it may be copied into the record. It is so many pages.

Mr. Adams: Well, any part you want omitted,——

Mr. Phleger: Let's put it all in.

Mr. Adams: That is all right. We will just introduce [1499] Judge Sloss' record, or deposition, in the record by consent of all counsel.

Mr. Clark: That is satisfactory. The original is on file, your Honor.

The Court: Very well.

Mr. Clark: Oh, yes. And also, may it please your Honor, there is an exhibit that was introduced on that deposition which should go in evidence in connection with it; being a letter, or a copy of a letter, dated November 14, 1939, identified on deposition as Railroad Defendants' Exhibit 555.

Mr. Phleger: Well, I suggest, instead of its being introduced, that it be copied in as part of the deposition.

The Court: Is it not attached to the deposition?

Mr. Clark: Well, it is not, because it was one of the depositions, or one of the exhibits marked on deposition, your Honor, and it is among the original exhibits that came along with all the depositions. It should be copied in along with the deposition at an appropriate place in this record.

Mr. MacKinnon: I think it is irrelevant and immaterial to any issue in the action, but I have no objection if your Honor wants it taken in.

The Court: It may be considered as part of the deposition?

Mr. Adams: Yes.

The Court: Very well.

The Clerk: You wish this copied by the reporter in the [1500] record, is that it?

Mr. Phleger: Yes, in connection with the deposition.

Mr. Clark: Well, if it is just copied in, it won't have to take a number.

(The deposition referred to appears in words and figures as follows:)

MARCUS C. SLOSS

a witness called on behalf of the plaintiffs in intervention, being first duly cautioned and sworn by the notary public to tell the truth, the whole truth, and nothing but the truth, testified as follows:

Direct Examination

By Mr. Clark:

Q. Will you please state your name and present address for the record?

A. Yes. My name is Marcus C. Sloss. Do you want my business address? 351 California Street. My residence is at 2790 Green Street, both in San Francisco.

Q. Are you admitted and licensed to practice law in the [1501] State of California?

A. Yes.

Q. For how long have you been admitted in this state?

A. Well, this month, November, it will be 55 years if we include the time during which I was on the bench.

Q. Were you a Justice of the Supreme Court of the State of California? A. I was.

Q. During what period, please?

A. From February, 1906, to February, 1919.

Q. Are you presently the senior member of the firm of Sloss & Eliot? A. I am.

(Deposition of Marcus C. Sloss.)

Q. During the years 1939 to 1945, were you the senior member of the then firm of Sloss & Turner of this city?

A. I was. I answered yes. I am not quite clear as to when Mr. Turner retired. It may have been earlier than 1945. It may have been '44.

Q. During your practice, Judge, have you specialized in any particular branches of the law?

A. Well, since I left the Supreme Court, I have conducted a general practice, and also have done a good deal of consulting work and work as special counsel in cases after they had reached the stage of being on appeal.

Q. Have you at any time specialized in federal tax matters?

A. No, except so far as they affected general clients of our office. [1502]

Q. Particularly, have you specialized in matters pertaining to corporate income and excess profits taxes payable to the government?

A. I say, except in so far as they affected my clients that were corporations.

Q. And is that true with respect to any work that you may have done concerning the filing of consolidated income and excess profits tax returns by corporations with the Federal Government?

A. No, I have not specialized in those matters particularly.

Q. At one time, were you retained to represent The Western Pacific Railroad Corporation in any matter?

A. I was.

(Deposition of Marcus C. Sloss.)

Q. Can you tell us about when that was?

A. The employment began in November, 1939. That was some four years after a reorganization proceeding had been instituted in the Federal Court, and after the Interstate Commerce Commission had promulgated a plan of reorganization, and reported it to the District Court here, for the Northern District of California; and it was at the time when the parties in interest had a right to file objections to the plan.

Q. At the time you were employed by the Corporation, what status did it have in the reorganization proceeding, if any?

A. The Corporation, as I understood then and have understood since, had not been directly represented in the proceeding before the Interstate Commerce Commission leading to the formulation of a plan. It was, however, a party in interest in two capacities: It was the owner of all of the stock, common and preferred, of the operating company; and it also held an unsecured claim of about \$5,000,000.00 against the Company for money advanced; and its holding of stock and its position as an unsecured creditor were both held or found to be without value in the proposed plan of the Interstate Commerce Commission; and it was given no participation in the reorganized company, or in any of the securities that were to be issued under the plan.

Q. What was the status of that plan at the time

(Deposition of Marcus C. Sloss.)

you were retained by the corporation in 1939?

A. The plan had been reported to the District Court, and the District Court had made an order calling upon all parties in interest to file their objections to the plan before a certain date, which, I think, was to be sometime in December of the same year. Following that, there was to be a hearing of the objections, and a decision by the court.

Q. I will show you a document which has been marked Railroad Company Defendant's Exhibit 555 in this case, being a letter dated November 14th, 1939, addressed to the Honorable M. C. Sloss, 111 Sutter Street, San Francisco, California, and signed T. M. Schumacher; and I will ask you whether you received the original of that letter on or about the date it bears, namely, November 14th, 1939?

A. Yes, I received the original of which this is a photostatic [1504] copy about that time.

Q. Judge, does that letter correctly describe your retainer by the Corporation at that time?

A. Yes.

Q. At some time did you cease representing the Corporation?

A. Well, yes. When the reorganization proceeding was completed, and it ultimately went to the Supreme Court of the United States, and after the incidental matters in the District Court here—United States District Court—had been completed, I considered that my employment was ended.

(Deposition of Marcus C. Sloss.)

Q. Approximately when was that?

A. Well, I made a little memorandum of dates from my records in regard to that.

Q. Will you please refer to it?

A. With the exception of the proceedings in the District Court with reference to allowances of fees and expenses to different counsel and to the parties in the proceeding, which, I think, were not terminated until 1945, I think the last matter that I had anything to do with was on the 2nd of June, 1944, when I participated briefly in an argument before Judge St. Sure in the District Court on the question of whether that court had jurisdiction to determine the ownership of accommodation collateral that had been furnished by the Western Pacific Railroad Corporation to the debtor. I think it was to the debtor. It may have been to someone else. [1505]

Q. Judge, during that period, namely, from November 14th, 1939, to June 2nd, 1944, did you represent the Corporation generally in all of its legal problems?

A. No. No, I considered that my employment was limited to representing the interests of the corporation as a stockholder and unsecured creditor of the debtor in the bankruptcy proceeding—or the reorganization proceeding.

Q. During that time, were you ever called upon by the Corporation to give any advice whatsoever in any federal tax matters?

A. No, I was not.

(Deposition of Marcus C. Sloss.)

Q. During that time, were you ever consulted by the Corporation with respect to any federal tax matters? A. I was not.

Q. Specifically, during that time, were you ever called upon to give any advice to the Corporation concerning the filing in its name of a consolidated income and excess profits tax return for the year 1943? A. No.

Q. Were you ever consulted in any manner with respect to that matter? A. No, I was not.

Q. During that period, were you ever called upon to give any advice to the corporation with respect to the filing in its name of a consolidated income and excess profits tax return for the taxable year 1944? [1506]

* * *

The Witness: I was not.

Q. (By Mr. Clark): Were you ever consulted in any respect concerning such return?

A. You are referring to the year 1944?

Q. Yes. A. I was not.

Q. During the period we are discussing, namely, from November 14th, 1939, until June 2nd, 1944, were you ever called upon by the Corporation to give any advice with respect to the filing in its name of a consolidated income and excess profits tax return for the taxable year 1942?

A. I was not.

Q. And were you ever consulted in any manner with respect to such return? A. No.

(Deposition of Marcus C. Sloss.)

Q. During that period, Judge, were you ever called upon to give any advice to the Corporation whatsoever concerning the filing in its name of a claim for refund with reference to income and excess profits tax for the taxable year 1942?

A. No.

Q. Or with respect to the taxable year 1942? (sic).

A. The same answer. I was not.

Q. Were you ever consulted in any manner at any time on that matter? A. No. [1507]

Mr. Clark: That is all from us.

Mr. Dickerson: No questions.

Examination

By Mr. Adams:

Q. Judge Sloss, in answer to several questions put by Mr. Clark, he inquired if you were called upon to give advice or to consider any other tax matters as stated in his questions; and you answered in the negative. Did you mean by "called upon," that no one called upon you requesting any such consideration or advice?

A. I don't think I quite got the question.

Mr. Adams: Read it, Mr. Reporter.

(Question read by reporter.)

A. Yes, that was my meaning.

Q. In reference to your representation of the

(Deposition of Marcus C. Sloss.)

Holding Corporation in the reorganization proceeding, you referred to your file and noticed that the last activity on your part other than that involving consideration of compensation, was an occasion sometime in the middle of 1944?

A. I don't remember what the date of that was. I think it was a little later. I think that matter was finally decided in Judge St. Sure's court in '45; but I can refer to other papers and get that date for you later.

Q. It is not necessary. I am just trying to be sure that I understood the testimony that you have given to Mr. Clark; and [1508] I haven't any intention to raise a question as to the particular date.

Is it not the fact that your representation of the Holding Company in the reorganization proceedings remained in force throughout the pendency of those proceedings from the time that you first appeared in behalf of the Corporation?

A. It remained in force—you mean until the reorganization was completed in the court proceedings?

Q. Yes. A. Yes, I do think it did.

Q. You did not withdraw from that representation at any time, as far as you recall?

A. No, I never withdrew from it. I have in my file—I happened to see it yesterday—a letter which I wrote, which I can find shortly, which settled a little matter of advancement of expenses between

(Deposition of Marcus C. Sloss.)

my office and Colonel Coulson's office; and in sending him a check for the small amount that was due him, I said that I think that this concludes my services in this matter; and that, I think, was in 1945; but I can find it if you would like to get the date.

Q. It may be that we should want to look at that.

You had in mind in appearing for the Corporation as you did in the reorganization proceedings, that you were appearing as an attorney for the Corporation generally for the purposes indicated by the statute? [1509]

A. Indicated by what?

Q. By the statute.

A. Oh, yes. Yes, for whatever came within the scope of that reorganization proceeding.

Q. You received as such attorney regularly the notices of hearings issued out of the reorganization court?

A. Yes. Yes, when I began, I might add, because of the fact that the Corporation had not been directly represented in the prior hearings before the Interstate Commerce Commission, I wrote a letter to the judge and to the parties in interest, calling attention to that fact, and asking whether I would be permitted on behalf of the Corporation to appear at the hearing on the plan, and to file objections, to which he answered in the affirmative; and then about the same time, on behalf of the Western Pacific Railroad Corporation, we

(Deposition of Marcus C. Sloss.)

asked leave to intervene in the proceeding, which leave was granted. If my memory is correct, Mr. Goodrich took the same course on behalf of the Western Pacific Railroad Company, which was also an unsecured creditor.

Mr. Goodrich: That is correct.

Mr. Adams: I have no further questions.

Re-Examination

By Mr. Clark:

Q. Judge, did you ever at any time give any advice whatsoever to the Corporation respecting any federal tax matter? [1510]

A. No, I did not.

Q. And at any time were any facts brought to your attention which made you feel that it was incumbent upon you to take any action or steps on behalf of the Corporation in any tax matter?

A. No. I don't know that this is a qualification of that answer; but, of course, one of the matters which were gone into very thoroughly in connection with the hearings both in the District Court and in the Circuit Court of Appeals and in the Supreme Court, was the matter of the earnings record of the Company, not only before the institution of the proceeding, but during it—even after the decision in the District Court, with the purpose of showing that the property had a greater value than was attributed to it by the Interstate Commerce Commission. And it may be—I have no

(Deposition of Marcus C. Sloss.)

definite recollection of it—that in looking over those statements of receipts and disbursements, there were items of taxes paid or taxes accrued; but I viewed it just as I viewed any other item of expense, without going into the detail or the supporting data; and I viewed it as an item of expenditure.

Mr. Clark: That is all from us.

Mr. Adams: We have no further questions.

Mr. Clark: Mr. Dickerson?

Mr. Dickerson: No questions.

The Witness: If you will permit me, I have that letter [1511] here with me, in case you would like to look at it.

Mr. Adams: Oh, yes. I hadn't appreciated that you had your files with you.

A. Yes. May I volunteer this testimony? I don't think it will do anybody any good or any harm.

Mr. Clark: Yes.

A. But for completeness, I find in my files a carbon copy of a letter dated June 15th, 1945, addressed to Robert E. Coulson, Esq., 40 Wall Street, New York, N. Y.

“Dear Colonel Coulson:

“In accordance with the order of Judge St. Sure dated May 21st, 1945, the Western Pacific Railroad Company has paid Sloss & Turner \$7,000.00, being the amount allowed for services during the period following the decision of the Circuit Court

(Deposition of Marcus C. Sloss.)

of Appeals, together with \$725.02 reimbursement for expenses incurred. The latter amount includes \$705.82, which has been paid to Sloss & Turner by your firm in July of 1943. Under date of July 20th, 1943, you sent us a check for \$780.91. On July 26th, 1943, I wrote you, pointing out that this was an overpayment of \$75.09, the check for which was sent you under cover of the last-mentioned letter. The balance remaining is \$705.82. A check for \$705.82 payable to Whitman, Ransom, Coulson & Goetz, is enclosed herewith."

And then follows the paragraph—the only one that has any bearing here. [1512]

"I take it that this closes my connection with the Western Pacific reorganization proceeding. Let me at this time express my pleasure in the association with you, and my appreciation of your many courtesies. With best regards,

"Yours very sincerely,"

and signed by me.

Re-Examination

By Mr. Adams:

"Mr. Adams: I have one or two more questions, possibly.

"Q. Judge Sloss, during the entire course of your representation of the Holding Corporation in the bankruptcy proceeding, were you entirely devoted, so far as your activities and work were concerned, to the interests of the corporation to the exclusion of any other interested party?

(Deposition of Marcus C. Sloss.)

“A. Yes, entirely.

“Q. And you were entirely free from any direction, domination or control by any other interested party, or any representative or agent of such party?

“A. Yes, my employment—my representation was directed towards getting, if we were able to do so, more recognition of the position of the corporation as a stockholder and as an unsecured creditor.

“Mr. Adams: No further questions.

“Mr. Clark: Nothing further, Judge. Thank you very much.

/s/ “MARCUS C. SLOSS.” [1513]

(The letter referred to reads in words and figures as follows:)

“November 14, 1939

Via air mail.

Hon. M. C. Sloss,
111 Sutter Street,
San Francisco, California.

My dear Judge Sloss:

At a meeting of the Board of Directors of the Western Pacific Railroad Corporation held on October 10, 1939, I was authorized as President of the Corporation to employ local counsel in San Francisco to represent the investment of this Corporation in the Federal District Court of California, Northern District, Southern Division, in the proceedings for reorganization of the Western Pa-

cific Railroad Company. This Corporation, as you know, not only owns all of the outstanding stock of the Western Pacific Railroad Company, but is a general creditor for [1513A] advances made to that company aggregating a substantial amount. Under the Commission plan which is now before the Federal Court in San Francisco for consideration the interest of this Corporation both as stockholder and general creditor is treated as of no value. This treatment of the claims of this Corporation is based entirely upon Commission estimates of future earnings, as both the investment, fully depreciated, in the Western Pacific Railroad Company and the valuation of the property of that company made by the Interstate Commerce Commission for rate purposes considerably exceeds the total of debts of the Western Pacific Railroad Company with accrued interest to date.

Mr. F. C. Nicodemus, Jr., of Pierce & Greer, of 40 Wall Street, New York, N. Y., is counsel for this Corporation. In the pending proceeding for the reorganization of the Western Pacific Railroad Company, however, he has appeared as counsel for that company, the debtor in the proceeding, both in the Court and before the Commission. He will continue to appear in the proceeding in that capacity. It is the view of the Board of Directors of this Corporation that it should have completely independent representation in the Court in order that its claims against the debtor, both as stockholder and as a general [1514] creditor, may be

effectively pressed upon the Court. While you will not be in any sense under the control or direction of Mr. Nicodemus, he, as counsel for the debtor, will be glad to help you or cooperate with you in any way you may wish, not inconsistent with his desire to maintain a position of neutrality as between the various classes of security holders.

This Corporation has about 5,000 stockholders. Mr. A. C. James and companies in which he is the dominating stockholder own approximately 40% of the stock of this Corporation. Mr. James' interests are represented by Mr. Coulson who is formally appearing in the reorganization proceeding for the A. C. James Co., which is a secured creditor of the Western Pacific Railroad Company. Mr. Coulson has told me that he is prepared to cooperate with you to the fullest extent you may desire in the preparation of your objections on behalf of this Corporation to the Commission's plan of reorganization, and in your presentation in support of such objections.

Mr. Coulson has further advised me that he has arranged to secure for you an assurance from the Curtiss Southwestern Company, that to the extent your reasonable and proper fees for services in this reorganization proceeding are not allowed by the Court in the [1515] proceeding or paid by this Corporation, the Curtiss Southwestern Company will make such payment to you. The Curtiss Southwestern Company is desirous in its own interest as a substantial stockholder in this Corporation that

an adequate and effective presentation of the case for the equity be made in the San Francisco court.

Yours very truly,

Original signed by

/s/ T. M. SCHUMACHER,
President."

Mr. Adams: Now I should like to call Mr. Levy.

Mr. Levy: Are you referring to me, Mr. Adams?

Mr. Adams: No, the witness is ready to testify, I believe.

Mr. Levy: I was prepared.

Mr. Adams: I think you were forewarned, as well.

Mr. Levy: Nevertheless it was quite a shock.

WILLIAM G. LEVY

called as a witness on behalf of the defendant, sworn.

The Clerk: Will you state your name to the Court, please?

A. William G. Levy, L-e-v-y.

Direct Examination

By Mr. Adams:

Q. Where is your place of business, Mr. Levy?

A. 526 Mission Street.

Q. That is the office of the Western Pacific Railroad Company?

A. That is correct.

(Testimony of William G. Levy.)

Q. And what is your office in the railroad company?

A. I am the auditor of the freight and passenger accounts.

Q. You have been engaged in business for the railroad company—that is, been an employee of the company—for a little over 25 years?

A. That is right.

Q. How long have you been the auditor of freight and passenger business?

A. Since July, 1948. [1517]

Q. And before that you had been assistant auditor of freight and passenger revenues?

A. Assistant auditor of freight and passenger accounts.

Q. And how long have you held that position?

A. Since September, 1937.

Q. And prior to that time you held various positions in the auditing department of the railroad your duties and responsibilities as auditor of freight and passenger revenue accounts?

A. That is correct.

Q. Now will you please describe the nature of your duties and responsibilities as auditor of freight and passenger revenues?

A. I am in charge of the department where we audit all of the freight and passenger revenues derived from the agents' accounts and inter-line accounts and also government accounts.

Q. Is your department a section of the auditing department? A. Yes, it is.

(Testimony of William G. Levy.)

Q. And who are your immediate superiors?

A. Mr. Gosney, the general auditor, and Mr. Strachan, the assistant general auditor.

Q. Now are you familiar with the handling of government accounts?

A. I am. That is one of the——

Q. That work is under your jurisdiction?

A. Yes, it is.

Q. Are you familiar with the terms "cut-backs" and "refunds"?

A. Yes, I am. [1518]

Q. Please state what your understanding of these terms is as regards government freight accounts.

A. Well, the government pays our bills prior to audit. They have been doing that for a good many years. Then when they get around to auditing it—it is quite a ways behind—they detect what they believe are overcharges, and they file claims with us for them. In some instances we make the refunds promptly, but in other cases when we do not, the government makes deductions from a current bill that they happen to be paying, and that deduction is termed a "cut-back."

Q. Now were you asked by Mr. Gosney to prepare an analysis of the cut-backs and refunds made since May, 1944, on government freight traffic that terminated on the Western Pacific system for the purpose of determining the total amount of such cut-backs relating to traffic moving in each of the years '42, '43 and the first four months of '44?

(Testimony of William G. Levy.)

A. Yes, I was.

Q. And when were you asked to make that analysis?

A. In the latter part of August, 1948.

Q. And did you make it? A. Yes, I did.

Q. When was it completed?

A. Early in October, '48.

Q. Was this analysis made by employees of the railroad company in your department under your personal supervision? [1519]

A. Yes, it was.

Q. Please describe how the work was done.

A. Well, I designated certain persons from the office to gather the information from the regular records and other persons to sort it according to the years, and finally operators to tabulate the figures to get the final results.

Q. Now I hand you a carbon copy of a tabulation entitled, "Re-Distribution of the Debits to Freight Revenue made during the Period 1944 to July 1948, inclusive, resulting from Government Cut-backs and Refunds on Government Shipments Terminated on the Western Pacific, Segregated to Year in which Traffic Moved," and I also hand you, Mr. Levy—strike that. I am handing you this carbon copy (handing to witness).

I have furnished counsel with copies of this sheet.

Is that a copy of the report which you rendered upon this subject? A. Yes, it is.

(Testimony of William G. Levy.)

Mr. Adams: Now, if your Honor please, I will ask, in lieu of marking the carbon copy, that, with the consent of counsel, a ribbon copy, which has been made from the carbon copy, be marked as Defendant's 51 for identification.

(Analysis prepared by the witness referred to above was then marked Defendant's Exhibit No. 51 for identification.)

Mr. Clark: Have you an extra copy there, Mr. Adams?

Mr. Adams: Yes, and I will ask that a copy of this be handed [1520] up to the Court.

(Copy of report handed to the Court through the Clerk.)

Q. (By Mr. Adams): Mr. Levy, do you believe the figures shown on the report are correct?

A. I do.

Q. Do they include any cut-backs or refunds that were made after July 31, 1948?

A. No, they do not.

Q. Can you tell me approximately the total amount of refunds and cut-backs that have been made since July 31, 1948, with regard to traffic terminating on the Western Pacific system?

A. They amounted to \$322,251.64.

Q. And what, approximately, was the Western Pacific's share of that amount?

A. I estimate that would be \$109,000.

Q. Are you continuing to receive claims for re-

(Testimony of William G. Levy.)

funds and cut-backs from day to day with respect to government traffic handled during the war years?

A. We are.

Q. Can you make any estimate of the total amount of refunds and cut-backs which may eventually be made with regard to wartime traffic?

Mr. Phleger: I object to that on the ground it calls for the conclusion of the witness.

Mr. Adams: I submit it, your Honor. [1521]

The Court: Sustained.

Q. (By Mr. Adams): Now, Mr. Levy, referring to Defendant's 51 for identification, the schedule, are any of the amounts shown in that schedule still in dispute? A. Yes, there are.

Q. In other words, some of the amounts which you had in this schedule are in dispute?

A. Yes, there are a good many items on which we rebilled the government to protect our claims, but most of those have either been withdrawn or settled. However, there is the amount of \$355,300.41, which we have not yet withdrawn as to these claims and of that amount I estimate that—

Mr. Phleger: Well, now, I ask that—

Mr. Adams: Go right ahead. I ask that the witness' answer not be interrupted.

Mr. Clark: He wasn't asked to estimate anything.

Mr. Phleger: I submit the answer is not responsive.

Mr. Adams: The objection was interpolated in

(Testimony of William G. Levy.)

the middle of the witness' answer. I wonder if the answer may not be completed, and then would be a proper time for the objection, after the question has been answered.

The Court: Well, can't the witness answer it a little more briefly, and then if it is necessary to make an explanation you may ask the witness. That gives your opponent an opportunity to object; otherwise he has to interrupt. [1522]

Mr. Adams: Surely.

Q. Now a moment ago, Mr. Levy, you mentioned the amount \$355,300.41, as being the aggregate of the amount still in dispute, which related to Defendant's 51 for identification?

A. That is right.

Q. Now approximately what part of that \$355,300.41 is the Western Pacific's share?

A. I estimate it to be \$120,000.

Q. Now taking the figures on Defendant's 51 for identification, which aggregate \$2,036,186.84, are those amounts the Western Pacific's share of cut-backs and refunds? A. They are.

Q. And they do not include the share of such cut-backs and refunds chargeable to connecting carriers? A. They do not.

Mr. Adams: I will offer Defendant's 51 for identification as Defendant's Exhibit 51, your Honor.

Mr. Phleger: Your Honor, I would like at this moment to make an objection, if this witness is

(Testimony of William G. Levy.)

not prepared to testify as to the years in which these payments were paid out. Otherwise, it is totally misleading, and I think is only a part of the story. It purports to say the year in which the transportation occurred, and we think we are entitled to know the year in which the payments or cut-backs were made. Now is this witness going to be prepared to testify to that? [1523]

Mr. Adams: Are you, Mr. Levy?

A. You are talking now about which figure?

Q. This same statement.

A. The statement of \$2,000,000?

Q. Yes, this \$2,000,000 statement shows the amounts of cut-backs and refunds on the debits between '44 and '48, which are related back to the years by determining the times when the traffic moved, is that right? A. That is right.

Q. Now then, what Mr. Phleger wants to know is, can you then translate these figures back again to the years in which the debits took place?

A. I can.

The Court: You mean the payments took place?

Mr. Adams: Or, as is stated here, the debits to freight revenue made. The same thing.

A. I can say they were all made subsequent to April, 1944.

Q. And they were made during the period May, '44, to July, '48? A. That's right.

Mr. Adams: So much shows here.

Mr. Phleger: I still object, because it is our

(Testimony of William G. Levy.)

position, and I think it is quite evident, that when a cut-back or refund credit, tax advantage was taken of it, and if the cut-back occurred in the last eight months of 1944, then this defendant received just as much advantage taxwise as if it had been allowed [1524] in this year, and so on, so that unless we know the years in which the tax advantage was taken, we have but part of the story. Now as I understand it, the exhibits put in evidence by Mr. Cockburn simply gave the gross tax effect in those years and gave no credit whatever for the tax advantage which in fact had been received, and we think we are entitled to have evidence of that if this is going in. [1525]

* * *

The Court: Wouldn't you then, in order to make that picture complete, have to show what the tax was in the years in which these refunds and cut-backs were advantaged by the corporation and then credited back in the hypothetical case? Otherwise it would not be a due reflection.

Mr. Levy: That is exactly what the government required in the Atchison ruling, and they so stated expressly.

Mr. Adams: The Atchison ruling is before your Honor. Of course, as far as the government is concerned, you are not going to get your deduction twice. That has been ruled more than once, and what opposing counsel are suggesting here is one way in which to determine the net tax savings. They say we can't have our deductions twice, but

(Testimony of William G. Levy.)

they put us against the proposition that we are not allowed to calculate anything on a hypothesis because, in order to hypothesize at all, you have to hypothesize something that is different from what took place. Now, I think it is true if you want to carry your tax calculations in and out and through in subsequent years, you are going to have different [1526] consequences, and then you are going to have consequences that pile on consequences, because that is the way the tax laws work. But, I take it, that this evidence as it stands is evidence of the amount of the cut-backs during those years. Now, as is suggested by opposing counsel, we need another specification of these figures—I think I am right; I will ask Mr. Levy—that we did not get the tabulations of the particular years from which they were taken when they were taken to these years.

Q. Is that right, Mr. Levy?

A. Will you repeat that question?

Q. (By Mr. Adams): Did you in making these calculations which carry all these figures back to the years when the traffic happened, did you also note the years in which the payments were finally received? In other words, in which the cut-backs finally operated?

A. No, we did not. [1527]

* * *

Mr. Adams: Before Mr. Levy addresses the court, may I ask the witness one question because of the suggestion in the last remarks of counsel

(Testimony of William G. Levy.)

that it would be easy to get the figures he would like to get? I would like to ask the witness how much work would be involved in picking the items making up these figures and positioning them with respect to the years in which the debit to freight revenue were made.

The Witness: It would be quite a job. It would take about—— [1532]

* * *

The Court: How else could you find out what the effect was of the payments which were made unless you recalculated all the income tax returns in the years in which these payments were actually made?

Mr. Adams: Let me see if I can get this clear with Mr. Levy.

Q. Mr. Levy, what you did to get this figure showing the amounts with respect to the time when the traffic was handled was to look at all the bills and get identification one by one of the traffic handled any time with relation to the cut-back or refund, is that right? A. That is right.

Q. Now, then, what you will have to do to get a figure after the time when the cut-back was taken into your accounts—how will you do that?

A. I just have to rearrange the very same records from which these figures were secured according to the date on which the deductions were made from our earnings. [1534]

* * *

(Testimony of William G. Levy.)

Mr. Adams: Your Honor, as to the offer of Defendant's 51 [1537] for identification in evidence, I have concluded to submit the offer without a request for leave to supplement, and take a ruling upon it as the record stands.

The Court: Well, I will reserve ruling on the admission of this exhibit until I have an opportunity to look at all the evidence in the case.

Mr. Adams: I have no further questions of Mr. Levy.

The Clerk: The exhibit will remain marked as 51 for identification, your Honor?

The Court: That is right. I will reserve ruling on the admission of the exhibit.

Any questions?

Mr. Phleger: No questions.

Mr. Clark: Nothing from us.

The Court: You may be excused.

(Witness excused.)

Mr. Adams: Your Honor, at this time I have some documents to offer for the record, and I will state briefly the purpose as I produce the documents. In support of the showing that the plaintiff corporation had no use in itself for its stock loss, we offer photostatic copies of the corporation income and declared value excess profits tax returns of the corporation for the year 1945, and the corporation income tax return of the corporation for the year 1946. I had made request that the plaintiff produce the originals, but I take it it would

be satisfactory [1538] to produce photostatic copies. They might be Defendant's Exhibit 52.

Mr. Phleger: I object to them upon the ground they are incompetent, irrelevant and immaterial.

Mr. Clark: Same objection, your Honor.

Mr. Phleger: Just because we are poor, it is not a matter of evidence. It hasn't anything to do with it.

The Court: Well, there is no objection as to the return itself?

Mr. Phleger: No, not on the ground of competency.

The Court: All right, let it be marked.

Mr. Clark: What is the number on it?

The Clerk: 52.

Mr. Adams: 52A and B?

The Court: For 1945 and 1946, did you say, or '44 and '45?

Mr. Adams: No, '45 and '46. And I direct attention in the '45 return to the amount shown under the net operating loss deduction of \$42,403,-256.08, being the remainder of that big loss after portions of it had been taken up in the prior returns.

The Clerk: The return for '45 will be marked 52A and the return for '46, 52B.

(Return for 1945 and return for year 1946 were marked 52A and 52B in evidence, respectively.)

Mr. Adams: Now, your Honor, I desire to read a resolution of the Board of Directors of the West-

ern Pacific Railroad Corporation [1539] at a meeting held September 5, 1935, my purpose being to show the fact that the plaintiff corporation recommended the appointment of Mr. Schumacher as one of the two trustees. I will read the resolution.

Mr. Phleger: Just a moment. We——

Mr. Adams: Just a moment; from page 927 of the record.

The Court: You say you admit that?

Mr. Phleger: We don't think it is material, but we will admit the fact.

Mr. Adams: May I read it?

Mr. Phleger: We won't agree to the admissibility, but we will admit the fact.

Mr. Adams: The fact being that the Board of Directors of the corporation on that date adopted a resolution as owner and holder of all the capital stock of the Western Pacific Railroad Company, recommending the appointment of Mr. Schumacher as one of the two trustees of the property of the Western Pacific Railroad Company, to be appointed at a hearing.

Mr. Phleger: Yes.

Mr. Adams: Very well, your Honor.

Now, I desire to offer as Defendant's 53 a photostatic copy of a letter of November 28, 1943, addressed by A. R. Baldwin, then an officer of the Western Pacific Railroad Corporation in New York, to C. M. Levey, president of the Western Pacific Railroad Company. [1540]

Mr. Clark: That is not '43, is it?

Mr. Adams: '23.

Mr. Clark: 1923?

Mr. Adams: Yes, right. And I will read briefly from it:

“I am enclosing herewith two statements showing the taxable income as reported to the Commissioner of Internal Revenue by the Western Pacific Railroad Corporation on consolidated returns for the years 1921 and 1922, and proposed allocation of the taxes to the various companies, the income of which is included in the returns. The total tax for 1921, \$31,813.09, was originally paid by the Western Pacific Railroad Company; and of the tax for 1922, \$114,929.64, three-quarters has been paid by the Western Pacific Railroad Corporation, which company will pay the remaining one-quarter, which will be due December 15, 1923. The method of allocation, vis., prorating the entire amount among the companies showing taxable income, is, so far as we are able to determine, the practice followed by other companies making consolidated returns.”

Mr. Phleger: Object to that on the ground it is irrelevant, incompetent and immaterial. It is over 20 years before the events here in litigation.

Mr. Adams: Well, the showing previously made being that the practice there described was since continuously followed. [1541]

The Court: Well, you have already in evidence an exhibit which factually shows the manner in which the returns were filed. What good does it do to put that letter in?

Mr. Adams: Particularly because the author, who describes the arrangement, refers to it as being in accordance with the general practice among railroads.

Mr. Clark: Which has already been proved, your Honor.

The Court: I don't see the competency of that, either.

Mr. Adams: I don't want to argue it, your Honor.

The Court: I think you have everything in the record that you need so far as the factual situation is concerned, in this very voluminous exhibit which gives all the facts as to what was done. I think this unnecessarily encumbers the record. I am inclined to be as liberal as is possible, but I think there is no need to put in a letter of 1923 in this litigation, because whatever is in evidence is admitted in evidence, and I am supposed to look at it, and so an alert lawyer is going to call attention to some conspicuous phrase in some document in 1923 when this case gets up into the Circuit Court, the record will show now that in my opinion, it just doesn't serve any useful purpose so far as the issues in this case, and I will sustain the objection.

The Clerk: Marked for identification, your Honor?

The Court: Oh, yes, of course.

(Letter dated November 28, 1923, referred to above was then [1542] marked Defendant's Exhibit 53 for identification only.)

Mr. Adams: Your Honor, I offer as Defendant's Exhibit 54 a series of letters, and I will state the nature of the letters and my purpose in offering them. The nature of the letters is this: It is correspondence between counsel to the corporation and Mr. Curry, first as secretary and treasurer and later as president of the corporation, concerning stockholders' meetings. It is offered in response to Plaintiff's Exhibit 19, which is a schedule of the corporation's stockholders' meetings, 1935 through 1948. It would not be offered at all were it not for the fact that that schedule is in the record now.

The Court: That schedule merely lists the dates of stockholders' meetings.

Mr. Adams: The point of the schedule, as I understand it, is to show that there were numerous meetings at which no quorum was present. The point of these letters is to show that in the letters consideration is given from time to time to the desirability of sending out proxies; the fact being that with proxies entirely outside of the James holdings, a meeting could have been held. Those gentlemen, the corporation officers, and the counsel, considered the matter and decided against it. We think that if the plaintiff's exhibit 19 is to stand in the record as indicative of anything, that we are entitled to put in the responsive showing.

The Court: You mean as to why the stockholders' meetings [1543] were not held?

Mr. Adams: - Precisely.

The Court: If that is the point of the correspondence, I think it would have bearing.

Mr. Adams: It is offered for that purpose.

The Court: Well, are you going to offer a lot of letters? What do they say? What do they talk about in those letters?

Mr. Adams: Well, take the first one, in order, which is addressed to counsel by the secretary and the treasurer of the corporation, and it asks:

“I should like to have your opinion as to how this year’s meeting should be handled. That is, will we pursue the same course as we did last year, sending out notices only, or should we proceed in the regular way? If we do the latter, it will entail considerable labor and expense, and it will be necessary on next Wednesday’s meeting of the Board to name a proxy committee, approve form of proxy, and a proxy statement.”

The Court: And what is the answer to that letter, or is that what you are——?

Mr. Adams: Yes, that letter is April 23, 1940, counsel’s letter in reply—or August 23, rather, counsel’s letter in reply of August 28, of the same subject matter on the same question says: [1544]

“It is our judgment that you should this year pursue the same course you pursued last year; that is, issue the notice in the usual form, but do not name a proxy committee or request proxies.

The Court: Now what counsel was that?

Mr. Adams: Mr. Nicodemus.

The Court: Well, I don’t suppose that your opponents are going to object to this.

Mr. Adams: It is offered only in response to

their showing about the stockholders' meetings in the absence of quorums.

The Court: And all the letters are along the same line?

Mr. Adams: Yes, your Honor.

The Court: Is there no objection?

Mr. Clark: We haven't seen them.

Mr. Phleger: I have no objection.

Mr. Adams: They are 700 to 714.

Mr. Clark: If that is the only purpose, there is no objection. I don't know what is in them.

The Court: Well, Mr. Adams has stated the gist of them. I assume that is what they are offered for.

Mr. Clark: Well, if that is the only purpose, there is certainly no objection.

The Court: Well, do you want them marked as one exhibit?

Mr. Adams: Yes, if your Honor please, Defendant's 54, [1545] consisting of a document now marked Railroad Company Defendants' 700, and those following, to 714 inclusive.

(Railroad Company's Exhibits 700 to 714 referred to above were thereupon received in evidence and marked Defendant's Exhibit No. 54.)

Mr. Adams: Now I have a set of letters which I can identify for counsel as Railroad Defendant's 410, 411, 413, 414, 417—417 includes a lawyer's memorandum—Interveners' 224 and 228; and I will state the nature of these letters.

Plaintiffs put in the exhibit Plaintiff's 45, which is an opinion rendered by Mr. Polk to the corpora-

tion with respect of Delaware franchise tax. The interveners put in on the same subject Interveners' Exhibits 5, 6, 7 and 8. We offer these documents, your Honor, which are dated in the years 1944 and 1945, and are correspondence between Mr. Curry, or rather, by Mr. Curry and by Mr. Nicodemus, dealing with that subject matter in response to the apparent effort of our adversaries to show treatment of this subject by Mr. Polk. We offer these to show that the subject was dealt with between the corporation and its own counsel, Mr. Nicodemus, at the same time.

The Court: Are counsel familiar with the correspondence?

Mr. Phleger: Yes. We have no objection to it at all.

Mr. Clark: Limited to that purpose, we have no objection, your Honor.

The Court: Very well.

Mr. Adams: Defendants' 55?

The Clerk: Defendants' 55.

(Railroad Defendants' Exhibits on deposition 410, 411, 413, 414, 417, and Interveners' Exhibit 224 and 228 were received in evidence and marked Defendants' Exhibit 55.) [1547]

Mr. Adams: Now, your Honor, we make an offering in response to the issue suggested upon yesterday's examination, concerning whether or not the plaintiff corporation knew that it had a right to file a separate return. The document which I now offer consists of the following: Interveners' 275,

a letter from the General Auditor in San Francisco to Mr. Curry asking if it were the intention of the corporation to file a consolidated return——

Mr. Clark: For what year, please?

Mr. Adams: I read you the date of the letter, didn't I? The date of the letter is February 8, 1941, and it is for the year 1940. Mr. Curry's letter of February 10, '41, stating:

"I have given this matter careful thought and deliberation, and feel that in accordance with the provisions of Section 730(a), the most equitable arrangement would be for us to dispense with the filing of a consolidated return in this particular instance."

Interveners' 279, a telegram of March 6, 1941, addressed by Mr. DeGraff to Mr. Curry:

"Do you wish me to prepare tentative declared value excess profits tax returns for each of the companies?"

Mr. Curry's telegram to Mr. DeGraff, Interveners' 280—these are all deposition numbers—of March 7, 1941, reading [1548] in part as follows:

"Find in looking into matter our accountant, who resigned in February, misunderstood just what is required. Holding company will file consolidated return as in previous years."

Interveners' Exhibit 80, telegram from Mr. Curry to Mr. DeGraff of March 1, 1945, reading in part as follows:

"By March 15 we will file here tentative consolidated returns for corporation for entire year in-

cluding its subsidiaries, to May 1, and you will file in San Francisco tentative consolidated return of company and its subsidiaries from May 1 to end of year, and consolidated return of Western Realty and its subsidiary from May 1 to end of year. As you know, one-fourth estimated tax liability must be paid at that time. These tentative returns are not binding, so if, after further calculation, it is found more advantageous to file separate returns, we will do so before June 15."

The Court: What year is that?

Mr. Adams: That is a telegram dated March 1, 1945, and refers to the returns for the year 1944. I offer these documents as Defendants' 56.

Mr. Phleger: Your Honor, I don't think these are material, but I do point out the fact that here is counsel dumping in a [1549] lot of exhibits like that. Mr. Curry was here on the stand, and he testified that all these type of wires were prepared for his signature, and he just signed them. I think it is highly improper at this stage of the trial to start in dumping in letters and telegrams sent by witnesses who have appeared and testified on the very subject. This should have been brought in on cross-examination of Mr. Curry.

Mr. Clark: Your Honor, I think Mr. Adams will concede that that last telegram he read from, with respect to the '44 returns, was established on deposition to have been prepared by Miss Valouch under Mr. Polk's advice.

Mr. Adams: As to the latter, I don't know, but

I am quite confident it was prepared by Miss Valouch.

Mr. Clark: Yes, although signed by Mr. Curry.

Mr. Adams: Well, Mr. Curry testified about all this practice. I have no purpose to contradict Mr. Curry's testimony in any respect, but what I do say is this, your Honor: The issue to which this response was directed was raised yesterday, presented to us yesterday, when a point was made that there was some kind of a difference between advising that it was preferable to file consolidated returns from a tax standpoint and advising that you had a right to file separate returns. That is the reason these things come in.

The Court: I think the testimony is limited to just whether or not the witness Polk had given advice, and there [1550] was some difficulty in getting that question squarely put and answered; but that was the extent of the examination on that subject, just as to whether or not he had made that statement to them. I do recall that the Court stated that that didn't close the door to you to show that there was an understanding on that subject on the part of the parties.

Mr. Adams: This is the current record that we offer in writing, and in response to that question.

Mr. Clark: We have no objection to it, your Honor.

Mr. Phleger: Well, it will be stipulated, will it, that with respect to the last telegram, that it was written by Miss Valouch under the direction of Mr. Polk and signed by Mr. Curry?

Mr. Adams: Whatever the record shows; and

Mr. Curry's deposition I will agree to. I have no recollection of any statement one way or the other relating to this particular telegram to Mr. Polk. If you have a recollection of that, please bring the record up, Mr. Phleger. We will agree on the deposition statement.

Mr. Clark: Well, it will take some time for us to find that pinpoint in the Curry deposition. I may be able to find it within a very few minutes.

The Court: Well, the correspondence may be admitted. I think the objection is not as to the admissibility, but really to the weight of these documents. [1551]

The Clerk: Exhibit 56.

(Intervenors' Exhibits 275, 276, 279, 280, 80, on deposition, were received in evidence and marked Defendants' Exhibit 56.)

Mr. Adams: Now further with respect to the tax matters, and having reference among other things to the testimony of Mr. Cockburn on the repositioning of the loss of the Deep Creek Railroad Company, and having reference also to the current record of the disposition of tax questions by Mr. Curry, I offer two letters, Railroad Exhibits 249 and 255, each of these being from Mr. Curry to Mr. DeGraff, and to indicate what I have in mind, I will read briefly from one of them.

Mr. Clark: Just a moment, please.

Mr. Adams: The dates are July 14, 1942, and August 25, 1942.

Are you ready?

Mr. Clark: Just a moment. Yes.

Mr. Adams: Exhibit 249 says, the second paragraph:

“With reference to the losses sustained account abandonment of Deep Creek Railroad, it has occurred to us that this loss might be considered by the Internal Revenue Bureau as a 1939 loss; in view of the fact that the Interstate Commerce Commission issued certificate permitting this abandonment July 1, 1939.” [1552]

And in 255, from the second paragraph:

“From the information contained in our records, it appears this loss should be charged off in 1939, as it is our understanding the Revenue Bureau has ruled such losses should be written off the year the securities have been ascertained as worthless. However, due to the large amount involved, we would not want to take it out of 1940 unless we are certain that there is no possible reason for keeping it in that year.”

Mr. Phleger: I submit these are totally and wholly immaterial and irrelevant. They are written in 1942 about tax transactions in '39.

Mr. Clark: They are also the type of letter, your Honor, that Mr. Curry testified was prepared by Miss Valouch in each instance, regarding tax matters, and he is not here to give us the benefit of that testimony, if there is any effect to be argued from that.

Mr. Adams: Your Honor, we have said before, and I think it is a fair statement, that the current written record at the time is the best evidence. I do

not offer this in any wise as contradicting any testimony that Mr. Curry gave. I offer it as current evidence of the things that he dealt with at the time.

Mr. Phleger: Well, then, it was certainly proper cross-examination [1553] of Mr. Curry; it is directed to showing that Mr. Curry, I suppose, was a very able tax man.

Mr. Adams: No, no, that is not a proper statement.

Mr. Phleger: Now, the appropriate time to have submitted this was when Mr. Curry was here.

Mr. Adams: I won't argue it further.

The Court: Well, is there very much materiality to this?

Mr. Adams: Your Honor has heard all the material that I consider significant.

The Court: This is the last document?

Mr. Adams: No, your Honor, I have two or three more.

The Court: Well, I can't see any particular materiality to it, but what bothers me more is that counsel may feel that it is a subject that they might want to cover, and Mr. Curry is gone—or is he still here?

Mr. Phleger: I think he is leaving tonight or tomorrow morning. We wouldn't counter it. It is wholly immaterial and irrelevant. That is the only point; it is just making a bigger record here, and we think it is wholly unnecessary.

Mr. Adams: We haven't caught up to the other party's numbers yet.

The Court: Well, I understand from Mr. Adams that we are getting to the end of the rope, so I think I will let it in.

The Clerk: 57. [1554]

(RR. Defendants' Exhibits 249 and 255 were received in evidence and marked Defendants' Exhibit 57.)

Mr. Adams: Now, your Honor, I offer as Defendants' Exhibit 58 a document now marked Railroad Defendant's Exhibit 950, being a copy of a letter dated December 17, 1945, addressed by Mr. Elsey to Mr. Wood, or to Wood, Walker & Company, 63 Wall Street, New York, and containing the following. The letter is written in answer to an inquiry from that company.

"With respect to the stock of the Western Pacific Railroad Company, I think that perhaps the best explanation is that contained in our 1944 annual report under the heading of 'Taxes,' which is quoted below."

And then follows the complete quotation of the statement under the heading of "Taxes," contained in the 1944 report.

We offer this as evidence of notice to the director Willis Wood, who was one of the directors of the plaintiff corporation at the time of this letter, and in view of the fact, your Honor, that his deposition here read in evidence indicates that his recollection was not clear or definite with regard to this matter, and he had some recollection that he did not know about it long after the date of this letter.

Mr. Phleger: Your Honor, that is a letter to the statistical department of a firm of which Mr. Wood was a limited partner, and he has testified in his deposition, which has been introduced in evidence, that he had no notice and received no [1555] notice from it.

The Court: This is a letter that went to what firm?

Mr. Adams: Mr. Willis Wood's firm, he being a limited partner in that firm. You recall the testimony that he had been a partner in a variety of investment houses, and this is the latest one, Wood, Walker & Company, in which he is now a limited partner. The gentleman is some 77 or 78 years of age at this time. This is the gentleman who had been for a good many years a member of the official body of the New York stock exchange.

I am just offering it to prove notice, your Honor, because these gentlemen's recollection of what they knew about this, in this case, was quite obscure.

The Court: Well, this elderly gentleman who was a limited partner in this firm in this period—I am now supposed to draw from this letter some evidence that he had notice?

Mr. Adams: Certainly. What this letter proves is that the very document that would give him notice went to his company. It was available, and we think that it is material in showing that, regardless of the inference your Honor draws further from it——

The Court: Well, I will sustain the objection.

Mr. Adams: May it be marked, if your Honor please, for identification as Defendants' Exhibit 58?

The Court: Yes. [1556]

(Letter dated September 17, 1945, Elsey to Wood, Walker & Company, was marked Defendants' Exhibit 58 for identification.)

Mr. Adams: Now next, your Honor, I desire to offer Railroad Defendant's Exhibits 795, 796 and 797. These are, respectively, schedules as respects Russell M. Van Kirk, deceased, of all purchases and sales of Western Pacific Railroad Corporation preferred stock; J. S. Farlee & Company, confirmation of all purchases and sales of preferred stock to April 10, 1948; and J. S. Farlee & Company, confirmation of purchases—wait. No, that is part of the same one. And Western Pacific Railroad Corporation preferred stock given by Russell M. Van Kirk to Mrs. Russell M. Van Kirk, and owned and held by her. These documents are offered, as were the similar schedules, with respect to the intervener Offerman, to which your Honor sustained an objection.

Mr. Clark: And to which we now object, your Honor, upon the same ground, that it is incompetent, irrelevant and immaterial.

Mr. Adams: Now may I say, your Honor will recall at that time we had some argument, and I don't want to repeat it at all, in which reference was made to the Comstock case, among other things. I have since looked at some cases with respect of a right of stockholders to intervene. That is what

these cases specifically are; they come up on motion to intervene, and there is authority, specifically on the proposition that the [1557] courts may hear and consider the investment position, the date year of acquisition and all the factors that are covered in these schedules, because these schedules, as your Honor well knows, are designed to show how late these gentlemen in this company came into this corporation and at what prices. I offer the schedules without imposing duplicate argument upon the Court; but I do think we are entitled to them, as I did think at the time.

Mr. Clark: We will object to them, your Honor, upon the ground it is incompetent, irrelevant and immaterial.

The Court: I will make the same ruling as I did in connection with the other exhibit; 59 for identification.

Mr. Adams: 59 for identification will consist of these three documents, your Honor.

The Court: Very well.

(Railroad Company's Exhibits 795, 796 and 797 on deposition were marked Defendants' Exhibit 59 for identification.)

Mr. Adams: Now, your Honor, I offer the Form 174 Revised, which is one of these monthly operating results, and general statistics, printed papers of the Western Pacific Railroad Company for the month of November, 1943. This is offered for a very limited purpose; the plaintiffs put in Exhibit 74 and 75 with regard to the 1943 income tax accruals,

and I don't remember which of these exhibits it is, or both of them, but they contain estimates of the amount of accrued tax liability [1558] in the amount of about \$8,250,000. Then the record shows that the accruals, as at the end of the year and before they were reversed, amounted to \$7,000,000. So there is an unexplained gap of a million and a half dollars. To meet that unexplained gap between those two papers, I offer this document, which shows that in November estimated back pay accrued on account of wage increase was entered in an amount of nearly a million dollars and had a corresponding effect on the tax accruals. That is the sole purpose, and if counsel will accept my statement, I needn't offer the document.

Mr. Phleger: I will accept the statement.

Mr. Clark: Accepted.

Mr. Adams: Now, then, your Honor, I should like to read from the minutes of a special meeting of the board of directors of the plaintiff corporation held at the residence of Mr. T. M. Schumacher in New York on Wednesday, August 13, 1947, and state the directors that were present at that meeting, who were: Mr. Curry, W. W. Hatton, F. C. Nicodemus, Jr., A. Perry Osborn, T. M. Schumacher, M. C. Valouch, and Willis D. Wood.

Now, at the page marked 103 of the minute book, of the minutes of that meeting, there appears the following:

“The Board considered at length the question of withdrawing the offer of settlement in view of the

fact that the Railroad Company refused to stipulate a withdrawal of its technical defenses. [1559] After full consideration, it was the judgment of the Board that any withdrawal of the offer of settlement would be prejudicial to this corporation and its stockholders."

I think counsel will agree with my further statement that the minutes of the meeting also contain a copy of the stipulation which was thereafter executed, and of counsel's opinion with regard to that stipulation.

Mr. Phleger: I object to it as incompetent, irrelevant and immaterial. It took place long after this suit was filed.

Mr. MacKinnon: The competency is conceded of all these documents.

Mr. Phleger: Yes, you are quite right. There is no objection on the ground of competency, but it is irrelevant and immaterial.

Mr. Adams: The relevance of the portion I read, your Honor, is this—it is relevant on two grounds and in two respects: In one respect, it shows certainly that this independent board of directors seriously considered a refusal to go along with the then pending offer of settlement. It is a curious coincidence that it happened that that was the date that the Commissioner accepted it, but this board didn't know that when it took this action.

Mr. Clark: Didn't know that?

Mr. Adams: It couldn't possibly be known until the [1560] second day.

Mr. Clark: Because the second Krigbaum letter, of course, was known.

Mr. Adams: Counsel of course can make his argument when his time comes, and I should not, perhaps, be arguing, but I was asked to reply to a statement with regard to the relevance of the offer I have just made, and I have stated one ground of relevance.

Now, another ground of relevance is this, your Honor: This is significant of the nature of the claim that is presented here to your Honor. It is significant that here, even at that date, with a settlement available that everyone knew was a very fine settlement to this transaction, these gentlemen, who hadn't a dime in the interest, only a claim in litigation, seriously gave consideration to throwing that settlement overboard unless the defendant corporation would waive the defense of the bar of reorganization.

Now, we think that is significant in this case, and we offer the material I have just read in support of that.

The Court: Well, what is the significance of it? You say you think it is significant?

Mr. Adams: It is significant of the nature of the equity that is brought before your Honor, that is in fact predicated upon a force position.

The Court: You mean that the Court should consider against [1561] the plaintiffs the fact that they were rather forceful about asserting their point?

Mr. Adams: Oh, no, your Honor; the thing they considered doing is the thing that, in my judgment, is indefensible.

The Court: Well, sometimes litigants, with resourceful attorneys, are very successful in holding a heavy cudgel over the heads of their opponents, if they want to get some result out of it. What has that got to do with the essential merits of this? It is just a little atmosphere to the thing that you don't like, because you think they were too tough about it. But that hasn't anything to do with the merits of the controversy itself. I don't see that it has any relevance in the matter.

Mr. Adams: Well, it certainly is material, is it not, your Honor, to establish the fact of the independence of this board of directors, it being still suggested that they were dominated and controlled?

The Court: Well, at that time counsel were here on both sides of the case in my court, presenting these very stipulations for approval, and for an order of court; so they were dealing then at arm's length. There wasn't any question about that. They were in here in court.

Mr. Adams: That is right.

Mr. Clark: In fact, the interveners came in and asked for an injunction on this very thing. [1562]

The Court: I will sustain the objection to the relevancy.

Mr. Adams: Very well, your Honor. I need not offer the document, since the offer I read was all the offer I intended to make.

Now, I have one further document. So I hope that is successful. The document is Railroad Company Defendant's Exhibit 120, and is a copy of the by-laws of the plaintiff corporation as amended to July 28, 1942; and being at the time it was produced, upon the taking of the depositions, the latest amendment. These by-laws describe the functions of the various officers, to which Mr. Curry has had reference from time to time in the course of his testimony.

The Court: Any objection to the by-laws of the corporation?

Mr. Phleger: No.

Mr. Clark: None from us, your Honor.

The Clerk: No. 60.

(Railroad Company Defendant's Exhibit 120, corporation by-laws, was received in evidence and marked Defendants' Exhibit 60.)

* * *

Mr. Matthew: If the Court please, it will take but a moment. I just want to suggest a stipulation that the final [1563] order of March 28, 1946, in the reorganization proceeding was served upon all parties to the reorganization proceeding as well as counsel, and the publication was also made in accordance with the terms of the order. That appears in the record.

Mr. Phleger: Subject to check, that is all right.

Isn't that recited in the final order itself, that notice was given?

Mr. Matthew: Oh, yes, as far as that is con-

cerned. I am talking about service of the final order itself. There is ample evidence—it also appears that the notice of the hearing upon the petition was likewise given in regular course, but I simply want to establish the fact that the final order was served in the regular course.

Mr. Phleger: If you say that it was, we will agree that it was.

Mr. Matthew: I think we need no stipulation to further orders because counsel will agree that they were received in regular course.

Mr. Adams: We rest.

Mr. MacKinnon: The defendant Western Realty Company rests, your Honor.

(Defendants rest.)

Mr. Phleger: The plaintiff will now offer in evidence as Plaintiff's Exhibit 81 the Federal corporation income and declared value excess profits tax return of the defendant [1564] railroad and affiliated companies for the calendar year 1945, and as 81-B the excess profits tax return for the same year, 1945, and as Plaintiff's next exhibit, 82, the corporation income tax return of the Western Pacific Railroad Company and affiliated companies for the calendar year 1946; and as the next exhibit, the corporation income tax return for the Western Pacific Railroad Company and affiliated companies for the calendar year 1947.

(The documents referred to were marked respectively Plaintiff's Exhibits 81-A, 81-B, and 82 and 83.)

The Court: Very well.

Mr. Phleger: The plaintiff rests.

Mr. Clark: Your Honor, we have only one formal matter [1565] on the part of the interveners, and that is according to the record at page 716 I did not get the concession which was agreed on substantially on pre-trial relative to the stock holdings and dates of acquisition of the intervening stockholders. The stipulation I asked for appears at page 716. The record does not indicate that anyone responded except Mr. Adams, who had some qualification of it, so I will now ask for the agreement and the concession I asked for, namely, that the intervenor Henry Offerman now owns 4,080 shares of the preferred stock of the plaintiff corporation; that he held 3,903 shares at the time the deposition in this case was taken, and has been a stockholder of the plaintiff since July 7, 1942; that the intervenor J. S. Farlee & Company, Inc., is now the owner of 10,000 shares of preferred stock of the plaintiff corporation, and at the time of the depositions—this is in answer to Mr. Adams' suggestion at the time I first asked for this concession—Farlee owned 9,320 shares and had been a stockholder since January 7, 1944; and that Meredith H. Metzger, formerly Meredith H. Van Kirk, who was substituted for her deceased husband by order of this Court on January 28, 1949, is the owner of 11,385 shares of the preferred stock of the plaintiff, 8,200 shares of which were distributed to her from the estate of her deceased husband, and that he had

been a stockholder, that is, Russell M. Van Kirk, of the plaintiff corporation since February 23, 1944. Now, may I have that concession from you, Mr. Phleger? [1566]

Mr. Phleger: Yes.

Mr. Clark: And Mr. MacKinnon?

Mr. MacKinnon: I am looking for the pre-trial minutes because I do not remember what was said. May I see the transcript? I will abide by whatever I agreed to abide by.

Mr. Clark: We offered a stipulation, if your Honor please, at the pre-trial, a written stipulation in which these figures and dates appear. The stipulation contained some other matters, it having been incorporated between Mr. Phleger's office and mine in the one stipulation, and with respect to this stockholders' matters, Mr. MacKinnon and Mr. Adams said that they would take at the trial our statement as to the amount of stock that was held and the dates of acquisition. They have had access to the certificates and opportunity to examine them on deposition. There is no question about the fact at all.

Mr. Adams: Your Honor, as I believe I stated at the pre-trial—and I am speaking from memory—I accept Mr. Clark's statement with regard to the present ownership of the number of shares held, but as I believe I further stated at the pre-trial, no concession on my part or agreement which I have made for the substitution of Mrs. Metzger, formerly Mrs. VanKirk, as a party is to relieve

her from the defenses good as against her husband. That was the understanding. On that understanding I will accept Mr. Clark's statement with regard to the number of shares of stock held by each of the interveners whose names he [1567] has called off.

Mr. Clark: And the dates of acquisition, Mr. Adams? And the dates I gave for the original acquisition?

Mr. Adams: I think they are correct, and I assume they check with the schedule.

Mr. Clark: They do, and I checked them.

Mr. MacKinnon: I will accept whatever I agreed to on pre-trial, your Honor. I have tried but I cannot find what I agreed to. Nobody has the minutes. I am not questioning their stockholdings.

The Court: Let us end it. Will you stipulate that you will accept Mr. Clark's statement subject to check?

Mr. MacKinnon: Certainly, subject to check.

The Court: If we do not hear from you to the contrary, you have agreed to it.

Mr. MacKinnon: Absolutely.

Mr. Clark: The interveners rest, your Honor.

Mr. MacKinnon: At this time I make a motion, as I made a motion at the end of the interveners' case, to dismiss the complaint and I am prepared to argue it at length or to save your Honor's burden of hearing it, whichever you desire, because I think the interveners have failed completely in making any case here, and I say that particularly in view of the reckless charges—the reckless

charges—and I am using the word advisedly, of these interveners with respect to Mr. Coulson, the James [1568] Foundation of New York, because there isn't an iota of evidence of conspiracy which they charge in their complaint. There is not an iota of evidence that the James Foundation of New York dominated or controlled this picture. There is not an iota of evidence that Col. Coulson dominated or controlled the stock situation for his benefit or for the benefit of the James Foundation. Those charges are reckless charges.

The Court: Mr. MacKinnon, you have made the motion. I wonder whether you cannot reserve your argument until we have some discussion and determine generally how this case is going to be submitted.

Mr. MacKinnon: Whatever you please, your Honor.

The Court: Do you gentlemen want to brief this case? I suppose you do. Or do you want to argue it, too? [1569]

* * *

PLAINTIFF'S EXHIBIT No. 6

Claim

To Be Filed With the Collector Where Assessment
Was Made or Tax Paid

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

☒ Refund of Tax Illegally Collected.

☐ Refund of Amount Paid for Stamps Unused, in Error or Excess.

☐ Abatement of Tax Assessed (not applicable to estate or income taxes).

State of New York

County of New York—ss.

Name of taxpayer or purchaser of stamps, Western
Pacific Railroad Corporation.

Business address: 37 Wall Street, New York 5,
New York.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed
2d N. Y.
2. Period (if for income tax, make separate form for each taxable year) from January 1, 1942, to December 31, 1942.

3. Character of assessment or tax, Corporation income and declared value excess profits tax.
4. Amount of assessment, \$4,201,821.54; dates of payment 3/15—6/15—9/14—12/15/43.
5. Date stamps were purchased from the Government.....
6. Amount to be refunded, \$4,201,821.54.
7. Amount to be abated (not applicable to income or estate taxes)
8. The time within which this claim may be legally filed expires, under Section 322(b)(1) of the Internal Revenue Code, on March 15, 1946.

The deponent verily believes that this claim should be allowed for the following reasons:

(See statement attached.)

WESTERN PACIFIC RAIL-
ROAD CORPORATION,

/s/ M. J. CURRY,
President.

Sworn to and subscribed before me this 9th day of March, 1945.

MARY C. VALOUCH,
Notary Public, Westchester
County.

Collector's Stamp.

[Stamped]: Received Collector of Internal Revenue, 2nd Dist. of New York, Mar. 9, 1945.

Western Pacific Railroad Corporation
Year 1942

Statement Accompanying Claim for Refund

The taxpayer is entitled, under the provisions of Section 23(s) of the Internal Revenue Code, to a net operating loss deduction in the amount of \$55,-093,108.70, computed in accordance with the provisions of Section 122 of the Code. Said net operating loss deduction is the amount of the reported net operating loss for the year 1943, which, in accordance with the provisions of Section 122, is a net operating loss carry-back for years beginning after December 31, 1940.

The details of the facts producing the net operating loss, the net operating loss carry-back and the net operating loss deduction are shown in full on the Federal tax return filed by the taxpayer for the calendar year 1943, which said return and its supporting schedules by this reference are made a part of this claim for refund.

The taxpayer requests the right, at the time this claim is reached for consideration, to file any further additional evidence deemed appropriate in the consideration of this claim, and it is further respectfully requested that before action is taken with respect thereto, an opportunity for hearing be granted the taxpayer.

Wherefore, the taxpayer alleges that it is entitled under the provisions of Section 23(s) of the Code to a net operating loss deduction in the above-stated amount computed under the provisions of Section

122(c) of the Code; that by reason thereof, there is no taxable net income for the year 1942; and that the tax paid for said year in the amount of \$4,201,821.54 constitutes an overpayment, claim for the refund of which, together with interest as provided by law, is hereby made.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 7

In the District Court of the United States, for the
Northern District of California, Southern
Division

No. 265080

THE WESTERN PACIFIC RAILROAD COR-
PORATION,

Plaintiff,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, SACRAMENTO NORTHERN RAIL-
WAY, TIDEWATER SOUTHERN RAIL-
WAY, DEEP CREEK RAILROAD COM-
PANY, THE WESTERN REALTY COM-
PANY, THE STANDARD REALTY AND
DEVELOPMENT COMPANY and DELTA
FINANCE CO., LTD.,

Defendants.

RUSSELL M. VAN KIRK, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a Cor-
poration,

Interveners.

STIPULATION AND AGREEMENT BE-
TWEEN PLAINTIFF AND DEFENDANTS
RELATING TO AGREEMENT WITH THE
BUREAU OF INTERNAL REVENUE

1. The Bureau of Internal Revenue has accepted
a proposal for the settlement of corporation income
and excess profits tax liability on behalf of the

Plaintiff's Exhibit No. 7—(Continued)

parties hereto, copies of which said proposal and acceptance are annexed hereto marked Exhibit A.

2. It is stipulated and agreed as follows:

(a) That the approval and acceptance of such settlement by the plaintiff and the defendants shall be without prejudice to the interests, claims or defenses asserted by the parties hereto, respectively, in the subject matter of this action and without prejudice to the position of the said parties inter se with respect thereto, and that all the interests and claims asserted by the said parties are to be determined with relation to, and as limited to, the net amount of alleged tax saving involved in this action as diminished by the settlement.

(b) More particularly, the claim for refund of taxes paid for the year 1942 shall not be deemed to have been abandoned by said settlement, but on the contrary said refund claim shall be deemed to have been diminished in the proportion in which the aggregate of the tax savings involved in this action shall have been diminished by the settlement, and as so diminished to have been allowed, paid to the plaintiff as the agent for the affiliated group designated in Regulations 104 and 110, and by the plaintiff paid into court, and the tax savings for the year 1943 and for the first four months of 1944 shall be deemed to have been diminished in like proportion. Nothing herein contained shall obligate any party hereto to make any deposit or payment into court.

(c) By acquiescence in such settlement none of

Plaintiff's Exhibit No. 7—(Continued)

the parties hereto waives any of its interests, claims or defenses in the above-entitled action, as against any other party, but all such interests, claims and defenses shall relate to the amount of tax savings as diminished by said settlement, and all parties stipulate and agree that the aggregate amount of the tax savings involved in or claimed in said action has been diminished by said settlement by the amount of \$4,201,821.54.

(d) Nothing herein contained shall be deemed to be or constitute a recognition or admission on the part of any party of the validity, merit or equity of the claims of any other party to said tax savings as reduced, or to any part thereof, or a waiver, surrender, or relinquishment in any manner or to any extent of the defenses or any thereof of any party to the claims of any other party in and to such tax savings, as reduced.

(e) In the event the said tax liabilities of the parties hereto shall not be finally settled in accordance with said agreement with the Bureau of Internal Revenue, this stipulation shall be of no force or effect whatsoever, and all the parties shall be released herefrom with like effect as if this stipulation had never been made.

Dated September 3, 1947.

/s/ LeROY R. GOODRICH,
/s/ F. C. NICODEMUS, JR.,

Attorneys for Plaintiff, The Western Pacific Railroad Corporation.

Plaintiff's Exhibit No. 7—(Continued)

ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
McCUTCHEN, THOMAS,
MATTHEW, GRIFFITHS &
GREENE,

Attorneys for Defendants, The Western Pacific
Railroad Company, Sacramento Northern Rail-
way, Tidewater Southern Railway Company,
Delta Finance Co., Ltd., and Standard Realty
and Development Company.

PILLSBURY, MADISON &
SUTRO,
FELIX T. SMITH.

EVERETT A. MATHEWS,
WHITMAN, RANSOM,
COULSON & GOETZ.

By EVERETT A. MATHEWS,
Attorneys for Defendant The
Western Realty Company.

Plaintiff's Exhibit No. 7—(Continued)

EXHIBIT A

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

February 11, 1947
(Copy)

The Honorable Joseph D. Nunan, Jr.,
Commissioner of Internal Revenue
Washington, D. C.

Attention: Mr. Frank Eddingfield

Re: The Western Pacific Railroad Corporation and
Affiliated Corporations

1942, 1943 and 1944 Federal Income Taxes

Dear Sir:

The Western Pacific Railroad Corporation and its affiliated subsidiaries filed consolidated returns for the calendar years 1942 and 1943 and the said Western Pacific Railroad Corporation filed a consolidated return for the calendar year 1944 including therein its said subsidiaries for the period from January 1, 1944, to April 30, 1944, during which period affiliation existed.

On the said return for 1942 a consolidated tax liability of \$4,201,821.54 was reported and duly assessed and paid. On the said return for 1943 there was reported a net loss and no taxable income. On the said return for 1944, based on a carryover of the unused 1943 net loss, there was reported no tax-

Plaintiff's Exhibit No. 7—(Continued)

able income and no tax liability. A claim for refund of the tax so paid for 1942, based on a carryback of the said 1943 net loss, was filed and is now pending in your office.

The taxpayer on behalf of itself and its aforesaid affiliated subsidiaries hereby offers to settle and determine the tax liabilities of the said corporations for the said taxable years 1942, 1943 and 1944 in the amounts shown on the returns filed as aforesaid. This proposal of settlement does not relate to or affect the tax liability of the said subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated. The within proposal is made without prejudice to any rights or claims of the parties, if the proposal is not accepted by you.

As part of this proposal The Western Pacific Railroad Corporation, on behalf of itself and its aforesaid affiliated subsidiaries agrees that, if this proposal is accepted, it will consent to a rejection of the said claim for refund of the 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is further agreed by the said The Western Pacific Railroad Corporation on behalf of itself and its aforesaid affiliated subsidiaries that if this proposal is accepted it will execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

Plaintiff's Exhibit No. 7—(Continued)

Authority for the submission of the within proposal of settlement by the undersigned is contained in a Power of Attorney heretofore filed in your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,

JAMES K. POLK,
Attorney-in-Fact.

EXHIBIT C

Treasury Department
Washington 25

Aug. 13, 1947

The Western Pacific Railroad Corporation
and Affiliated Companies

c/o Mr. James K. Polk
40 Wall Street
New York 5, New York

In re: Years—1942, 1943 and 1944

Gentlemen:

Reference is made to your letter dated February 11, 1947, regarding the examination of income and profits tax returns for the years indicated above.

You are advised that all the administrative action in connection therewith, based upon the record supplied this office by the internal revenue agent in

Plaintiff's Exhibit No. 7—(Continued)

charge, has been completed and the returns placed in the closed files.

Very truly yours,

/s/ E. I. McLARNEY,

Deputy Commissioner.

EXHIBIT D

Treasury Department

Washington 25

Aug. 26, 1947

The Western Pacific Railroad Corp.

c/o Mr. J. K. Polk

40 Wall Street

New York 5, New York

In re: Claims for refund of \$4,201,821.54
\$7,454.73 and \$161,449.48 for the year
1942

Gentlemen:

In accordance with the provisions of section 3772(a)(2) of the Internal Revenue Code, this notice of disallowance in full of your claim or claims is hereby given by registered mail.

By direction of the Commissioner:

Very truly yours,

/s/ E. I. McLARNEY,

Deputy Commissioner.

[Endorsed]: Filed Sept. 5, 1947.

[Endorsed]: Filed Feb, 1, 1949. (Plaintiff's Exhibit No. 7.)

PLAINTIFF'S EXHIBIT NO. 8

In the Southern Division of the United States District Court for the Northern District of California

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

ORDER APPROVING
PLAN OF REORGANIZATION FOR DEBTOR

These proceedings coming on for hearing on the modified plan of reorganization for the Debtor, approved by the Interstate Commerce Commission in its Report and Order entered June 21, 1939, and certified to this Court by said Commission on September 28, 1939, together with a transcript of the proceedings before said Commission and a copy of its said Report and Order approving said modified plan, and the Court having considered the entire record in these proceedings, including the transcript of the proceedings before said Commission certified to this Court and the evidence adduced and arguments presented at the hearing before this Court on January 22 to 25, 1940, and the Court having heretofore on August 15, 1940, filed its opinion herein,

Plaintiff's Exhibit No. 8—(Continued)

The Court Finds:

1. The findings of fact made by the Interstate Commerce Commission in its Original Report of October 10, 1938, as modified by its Supplemental Report of June 21, 1939, are supported by the evidence, and as supplemented by the stipulation of the parties filed herein on December 20, 1939, are adopted as findings by this Court.

2. The Plan of Reorganization, approved by the Report and Order of the Interstate Commerce Commission of June 21, 1939:

(a) Includes provisions modifying and altering the rights of creditors of the Debtor;

(b) Provides for fixed charges (including fixed interest on funded debt, interest on unfunded debt, amortization of discount on funded debt, and rent for leased railroads) in such an amount that, after due consideration of the probable prospective earnings of the property, in light of its earnings experience and all other relevant facts, there should be adequate coverage of such fixed charges by the probable earnings available for the payment thereof;

(c) Provides adequate means for the execution of the Plan; and

(d) In all other respects complies with the provisions of Subsection (b) of Section 77.

Plaintiff's Exhibit No. 8—(Continued)

3. Said Plan of Reorganization.

- (a) Is fair and equitable;
- (b) Affords due recognition to the rights of each class of creditors and stockholders;
- (c) Does not discriminate unfairly in favor of any class of creditors or stockholders;
- (d) Will conform to the requirements of the law of the land regarding the participation of the various classes of creditors and stockholders; and
- (e) Provides for payment of all costs of administration and all other allowances made or to be made by this Court.

4. By order entered August 15, 1940, this Court fixed the amount to be paid by the Debtor, or any corporation acquiring its assets, for fees and expenses incident to the reorganization through October 31, 1939. Said amounts are reasonable and within maximum limits heretofore fixed by the Interstate Commerce Commission and said order constitutes full disclosure of the approximate amounts to be paid by the Debtor, or such other corporation, for such fees and expenses so far as they could be ascertained at the date of said hearing before this Court on January 22 to 25, 1940. Such additional amount as may be required to be paid by the Debtor or such other corporation for services performed and expenses incurred (includ-

Plaintiff's Exhibit No. 8—(Continued)

ing reasonable attorneys' fees) after October 31, 1939, in connection with the proceeding and plan of reorganization, and in connection with the carry-out of said plan, if the same is finally confirmed, cannot be ascertained at this time, but such amounts will be subject to the approval of this Court within maximum limits hereinafter to be fixed by the Interstate Commerce Commission.

5. By order entered August 20, 1935, this Court divided the creditors and stockholders of the Debtor into classes and the classes of creditors hereinafter referred to are those fixed by said order.

Wherefore, It Is Ordered:

First: The objections to the Plan of Reorganization approved by the Report and Order of the Interstate Commerce Commission of June 21, 1939, and the claims for equitable treatment heretofore filed herein by or on behalf of the Debtor, the Institutional Bondholders Committee, the Trustee under the Debtor's General and Refunding Mortgage, A. C. James Co., Reconstruction Finance Corporation, The Railroad Credit Corporation, The Western Pacific Railroad Corporation and The Western Realty Company are hereby severally overruled and denied.

Second: Said Plan of Reorganization is hereby in all respects approved.

Third: The findings made by the Interstate

Plaintiff's Exhibit No. 8—(Continued)

Commerce Commission that the interests of the following classes of creditors:

(a) The Debtor's equipment obligations to be assumed by the Reorganized Company, being classes 6, 7, 8 and 9;

(b) Claims against the Debtor entitled to priority over any mortgage of the Debtor, current liabilities and obligations incurred by the Trustees of the Debtor during this reorganization proceeding, and expenses of reorganization allowed by this Court within the maximum limits fixed by the Interstate Commerce Commission, which shall be paid in cash or assumed by the Reorganized Company, and which are unclassified;

(c) Executory contracts of the Debtor which have been affirmed or have not been disaffirmed by the Trustees of the Debtor and not terminating prior to the conclusion of this reorganization proceeding which are to be assumed by the Reorganized Company and which are unclassified;

(d) Executory contracts made by the Trustees of the Debtor with the approval of this Court which by their terms do not terminate at or prior to the conclusion of this reorganization proceeding, which are to be assumed by the Reorganized Company, and which are unclassified; and

(e) All taxes levied, assessed or accrued

Plaintiff's Exhibit No. 8—(Continued)

against the Debtor or its property or against any subsidiary and remaining unpaid at the date of the confirmation of the plan, which are to be assumed and paid by the Reorganized Company with the same relative priority that they now have with respect to other obligations of the Debtor;

will not be adversely and materially affected by said Plan of Reorganization is hereby affirmed, and said Plan of Reorganization shall not be submitted to any of such classes for acceptance or rejection.

Fourth: The findings of the Interstate Commerce Commission that, at the time of the finding, the interests of unsecured creditors of the Debtor and the equity of the holders of the Debtor's Preferred Stock and the Debtor's Common Stock have no value, and that the holders of such unsecured claims and such shareholders are not entitled to participate in the distribution of new capital securities or other assets of the Debtor under said Plan of Reorganization is hereby affirmed, and said Plan of Reorganization shall not be submitted to said unsecured creditors or shareholders for acceptance or rejection.

Fifth: The only classes of creditors to whom said Plan of Reorganization shall be submitted for acceptance or rejection are:

(a) Class (1)—holders of claims evidenced by The Western Pacific Railroad Company

Plaintiff's Exhibit No. 8—(Continued)

First Mortgage 5% Bonds due March 1, 1946, issued under the First Mortgage of The Western Pacific Railroad Company dated June 26, 1916, and the interest coupons appurtenant thereto;

(b) Class (3)—Debtor's secured promissory notes issued to A. C. James Co., dated March 28, 1932, and May 31, 1932, respectively, bearing interest at the rate of 5% per annum and due March 28, 1935, and May 31, 1935 (respectively, together with the accrued and unpaid interest thereon;

(c) Class (4)—Debtor's secured promissory notes to Reconstruction Finance Corporation, dated March 1, 1932, June 29, 1932, August 1, 1932, August 30, 1932, and March 25, 1933, respectively bearing interest at the rate of 6% per annum, and due March 1, 1935, June 29, 1935, August 1, 1935, August 30, 1935, and March 25, 1936, respectively, together with accrued and unpaid interest thereon:

(d) Class (5)—Debtor's secured promissory notes to The Railroad Credit Corporation, dated June 29, 1932, and March 25, 1933, respectively, bearing interest at the rate provided for in the Marshalling and Distributing Plan, 1931, of The Railroad Credit Corporation, each note payable on demand, together with accrued and unpaid interest thereon.

Plaintiff's Exhibit No. 8—(Continued)

Sixth: T. M. Schumacher and Sidney M. Ehrman, Trustees of the Debtor, be, and they are hereby directed to send a certified copy of this Order and a certified copy of the opinion of this Court filed herein on August 15, 1940, to the Interstate Commerce Commission for use in submitting said Plan of Reorganization hereby approved to the holders of said claims and interests found to be entitled to vote thereon.

Dated: August 15, 1940.

A. F. ST. SURE,

United States District Judge.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT NO. 10

In the District Court of the United States for the
Northern District of California, Southern
Division

No. 26591-S

In Proceedings for the Reorganization of a Railroad

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER CONFIRMING PLAN
OF REORGANIZATION

These proceedings coming on for further hearing pursuant to the order of this Court entered herein on September 22, 1943, and upon the notice provided to be given by said order, for the purpose of determining whether or not the plan of reorganization heretofore approved by the order of this Court entered herein on August 15, 1940, shall be confirmed, and this Court having considered the record in these proceedings and having heard all parties in interest desiring to be heard in support of or in opposition to the confirmation of said plan of reorganization and being fully advised in the premises,

The Court Finds:

1. Due notice of said hearing has been given

Plaintiff's Exhibit No. 10—(Continued)

in accordance with said order of this Court entered herein on September 22, 1943.

2. This Court has jurisdiction of the subject matter of these proceedings and of all of the parties in interest.

3. On July 15, 1943, in conformity with subsection (e) of Section 77 of the Bankruptcy Act, as amended, said plan of reorganization was duly submitted by the Interstate Commerce Commission for acceptance or rejection to the creditors of Classes 1, 3, 4 and 5. In view of the findings of the Interstate Commerce Commission contained in its order dated June 21, 1939, in Finance Docket No. 10913, and the findings of this Court contained in said order entered herein on August 15, 1940, submission of said plan of reorganization to any other class of creditors or to any class of stockholders is not necessary under subsection (e) of Section 77 of the Bankruptcy Act, as amended.

4. On September 15, 1943, the Interstate Commerce Commission duly filed herein its certificate dated September 4, 1943, in which it duly certified to the Judge of this Court the results of said submission.

5. Said plan of reorganization has been duly accepted by or on behalf of creditors of each class to which submission is required under subsection (e) of Section 77 of the Bankruptcy Act, as

Plaintiff's Exhibit No. 10—(Continued)

amended, holding more than two thirds in amount of the total of the allowed claims of such class which have been reported in said submission as voting on said plan of reorganization, submission of said plan of reorganization to any class of stockholders not being required under said subsection (e), and such acceptances have not been made or procured by any means forbidden by law.

6. The United States is not a creditor of the Debtor on claims for taxes or customs duties, unless it be on claims for the payment of which said plan of reorganization duly provides.

7. All requirements for the confirmation of said plan of reorganization pursuant to Section 77 of the Bankruptcy Act, as amended, have been duly complied with, and said plan of reorganization should be confirmed.

8. This Court has this day filed herein an opinion containing a statement of the Court's conclusions and reasons for confirming said plan of reorganization.

9. Article R of said plan of reorganization, among other things, provides:

“The plan shall be carried out under the supervision of a reorganization committee consisting of three persons, all to be approved by the court, who shall be designated, one by the bondholders committee, one by the Reconstruction Finance Corporation,

Plaintiff's Exhibit No. 10—(Continued)

and one by the Railroad Credit Corporation and the A. C. James Company jointly.”

In conformity with said Article R, Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson have been duly designated for membership on said reorganization committee, said Frederick H. Ecker having been designated by Frederick H. Ecker, John W. Stedman and Reeve Schley, constituting the Committee representing a Group of Institutional Holders of the First Mortgage Bonds of the Debtor, said Frank C. Wright having been designated by Reconstruction Finance Corporation, and said Robert E. Coulson having been designated by The Railroad Credit Corporation and A. C. James Co. jointly. This Court is satisfied that said Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson should be approved as members of said reorganization committee.

Wherefore, It Is Ordered:

First: Said plan of reorganization heretofore approved by the order of this Court entered herein on August 15, 1940, is hereby confirmed.

Second: The designation of Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson as members of the reorganization committee provided for in Article R of said plan of reorganization is hereby approved. Said reorganization committee shall have the powers of and authority provided for in said plan of reorganization and shall have full

Plaintiff's Exhibit No. 10—(Continued)

power and authority, under and subject to the supervision and control of this Court, to put into effect and carry out said plan of reorganization and the orders of this Court relative thereto, the laws of any State or the decision or order of any State authority to the contrary notwithstanding. This Court hereby reserves the power, subject to the provisions of Section 77 of the Bankruptcy Act, as amended, and said plan of reorganization, further to define, extend, amend, or otherwise change the powers and duties of said reorganization committee and to enter orders approving or disapproving any action on their part. As provided in Article B of said plan of reorganization, the members of said reorganization committee shall not be liable for any action taken by them in good faith or by any person employed by them in good faith, except for their respective individual malfeasance or willful neglect. To the extent necessary to give effect to the provisions of this paragraph, the members of said reorganization committee shall be indemnified and held harmless against any loss or expense, by the Trustees of the properties of the Debtor until the properties of the Debtor shall have been surrendered by said Trustees and thereafter by the Debtor or such other corporation as may acquire said properties pursuant to said plan of reorganization.

Third: Jurisdiction of these proceedings and of all parties in interest is hereby retained for the pur-

Plaintiff's Exhibit No. 10—(Continued)

pose of entering such other and further orders as this Court may determine to be necessary.

Fourth: As used in this order, the term "parties in interest" shall include the Debtor, all parties to these proceedings, all indenture trustees, and all creditors and stockholders of the Debtor.

Dated: October 11, 1943.

/s/ A. F. ST. SURE,

United States District Judge.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT NO. 11

Agreement by and Between

The Western Pacific Railroad Corporation,
The Chase National Bank of The City of New York,
Central Hanover Bank & Trust Company,
James Foundation of New York, Inc., and
Frederick H. Ecker, Frank C. Wright and Robert
E. Coulson, As the Reorganization Committee
of The Western Pacific Railroad Company.

Dated November 22, 1943.

Agreement by and between The Western Pacific Railroad Corporation, a Delaware Corporation, hereinafter called the "Holding Company," The Chase National Bank of the City of New York,

Plaintiff's Exhibit No. 11—(Continued)

Central Hanover Bank & Trust Company and James Foundation of New York, Inc., hereinafter called collectively the "Secured Creditors," and Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, hereinafter called collectively the "Reorganization Committee,"

Witnesseth:

The Subject Matter of the Agreement

The Holding Company is indebted to each of the Secured Creditors for money loaned upon a promissory note or promissory notes now in default, against each of which notes certain securities were delivered as collateral by the Holding Company. The aggregate of the indebtedness of the Holding Company to all the Secured Creditors for principal and interest, as of September 30, 1943, is \$10,547,423.85 which is approximately \$5,650,863.00 in excess of the then market value (approximately \$4,896,560.00), of all the collateral then held by the Secured Creditors. Annexed hereto and designated as Schedules A, B and C, respectively, are statements as to the aforesaid indebtedness of the Holding Company to each of the Secured Creditors and the collateral now or heretofore held by the Secured Creditors as security therefor.

The Holding Company desires to secure the release and discharge of its aforesaid indebtedness to each Secured Creditor, principal and interest, in

Plaintiff's Exhibit No. 11—(Continued)

so far as such indebtedness cannot be satisfied by the collateral held by such Secured Creditor (not including as part of such collateral the preferred and common stock of the Railroad Company hereinafter mentioned); and the Secured Creditors severally desire to apply such collateral in satisfaction of the indebtedness, and to secure the release by the Holding Company of any claims it may have arising out of the previous disposition by them of collateral.

The Holding Company owns all of the outstanding preferred and common stock of The Western Pacific Railroad Company, a California corporation (hereinafter called the "Railroad Company"). The Railroad Company is now in reorganization under Section 77 of the Bankruptcy Act, and the plan of reorganization thereof, approved by the Interstate Commerce Commission by its order of June 21, 1939 (hereinafter called the "Plan"), was duly confirmed by order of the United States District Court, Northern District of California, Southern Division, on October 11, 1943. Said preferred and common stock of the Railroad Company was declared to be without equity or value by an express finding of the Interstate Commerce Commission in its said order of June 21, 1939, which finding was duly adopted by the aforesaid Court, and under the Plan said stock is required to be cancelled. The certificates representing said preferred and common stock of the Railroad Company are in the possession

Plaintiff's Exhibit No. 11—(Continued)
of The Chase National Bank of the City of New York, which claims a lien thereon.

Frederick H. Ecker, Frank C. Wright, and Robert E. Coulson are the members of the Reorganization Committee of the Railroad Company, constituted pursuant to subdivision R of the Plan, and approved as such Reorganization Committee by order of the United States District Court, Northern District of California, Southern Division, on October 11, 1943.

Subject to the jurisdiction of the aforesaid Court, the Reorganization Committee is under the duty of determining the method of carrying out the Plan under the supervision of the Committee. Action by the holders of the preferred and common stock of the Railroad Company may become necessary with respect to the various corporate steps incident to carrying out the Plan and making the same effective. The Reorganization Committee is desirous and the Holding Company is willing that the aforesaid stock of the Railroad Company be held at the disposal of the Reorganization Committee for the purpose of carrying out the Plan and making the same effective and that in connection therewith the Holding Company, as the sole stockholder of the Railroad Company, take such action as the Reorganization Committee may from time to time request.

Plaintiff's Exhibit No. 11—(Continued)

Agreements

I.

The Holding Company agrees to assign, set over and transfer to each of the Secured Creditors, severally and respectively, the securities pledged to such Secured Creditor and still held by it as shown by the statement as to the indebtedness to such Secured Creditor annexed hereto (Schedule A, B or C, as the case may be), and the Holding Company also agrees to release to each Secured Creditor, all rights and interests which the Holding Company has, or might claim to have in and to said collateral, including any rights or interests which the Holding Company has or might claim with respect to collateral heretofore sold by such Secured Creditor as shown by the aforesaid statement. Each Secured Creditor agrees to assume such Federal and State stamp taxes, if any, as may be payable with respect to said transfer to it of pledged securities.

Each Secured Creditor agrees to cancel and surrender to the Holding Company the collateral notes held by such Secured Creditor and more specifically described in the statement as to the indebtedness to such Secured Creditor annexed hereto (Schedule A, B or C, as the case may be), and to release and discharge the indebtedness represented by said notes, principal and interest, in full.

Each Secured Creditor consents to the assignment or transfer to the other Secured Creditors and each of them, of the securities to be transferred by the

Plaintiff's Exhibit No. 11—(Continued)

Holding Company to such Secured Creditors, pursuant hereto, and waives any inequalities in connection with the satisfaction of the indebtedness of the Holding Company to the Secured Creditors, respectively, that may result from the carrying out of this agreement.

The agreements herein contained on the part of the Secured Creditors to be performed are several and none of the Secured Creditors shall be liable for the performance by the other Secured Creditors of their respective agreements; nor shall any partnership or joint relationship between said Secured Creditors be construed to flow from the execution of this instrument.

II.

The Holding Company, as the owner of all the outstanding preferred and common stock of the Railroad Company, agrees to cooperate with the Reorganization Committee in carrying out the Plan and making the same effective by whatever method, in conformity with the Plan, the Reorganization Committee may determine upon, and (in furtherance of this general commitment and not in limitation thereof) the Holding Company particularly agrees that (a) upon written request of the Reorganization Committee, the Holding Company will assign, transfer and deliver or cause to be assigned, transferred or delivered to the Reorganization Committee or the nominee or nominees of the Reorganization Committee, all of the preferred and

Plaintiff's Exhibit No. 11—(Continued)

common stock of the Railroad Company, if the aforesaid United States District Court shall determine such assignment and transfer to be necessary or desirable for the purpose of carrying out the Plan or making the same effective; provided, however, that if any Federal or State stock transfer taxes shall lawfully be applicable to such transfer, provision for the payment of such taxes shall be made by the Reorganization Committee and the Holding Company shall not be obligated for the payment thereof; and (b) from time to time until the preferred and common stock of the Railroad Company has been transferred, as aforesaid, or, if no such transfer be made, until such stock is surrendered for cancellation in accordance with the Plan, the Holding Company, upon written request of the Reorganization Committee, will take such action as the owner of the aforesaid stock of the Railroad Company (whether by voting said stock at meetings of stockholders of the Railroad Company or by the execution and delivery of appropriate authorizations, consents or other written instruments) as may be necessary to authorize such corporate action by the Railroad Company (including, without limitation thereto, the amendment of its Articles of Incorporation and By-Laws and the execution and delivery of the mortgages provided for in the Plan), as the Reorganization Committee may deem necessary or convenient for the purpose of carrying out the Plan and making the same effective.

Plaintiff's Exhibit No. 11—(Continued)

Any action taken by the Holding Company, as the owner of the preferred and common stock of the Railroad Company, pursuant to the agreement in this paragraph contained, and the making of any provision by the Reorganization Committee as to the payment of Federal and State stock transfer taxes, if any such taxes shall lawfully be applicable to the above mentioned transfer, are subject to the approval of the United States District Court, Northern District of California, Southern Division, in the proceeding pending in that Court for the reorganization of The Western Pacific Railroad Company (No. 26591-S).

If the finding of the Interstate Commerce Commission that the preferred and common stock of the Railroad Company is without equity or value shall be annulled, set aside or reversed, whether by Act of Congress or otherwise, or if, for any reason, the Plan shall not be carried out, then the Holding Company and each of the Secured Creditors shall be entitled to be restored to the same rights, claims and privileges with respect to such preferred and common stock as existed immediately preceding the execution of this agreement, and this agreement shall not be deemed to affect or prejudice any such rights, claims or privileges and the physical possession of the certificates for said preferred and common stock (provided said certificates shall not theretofore have been surrendered to the reorganized company or its agent for actual cancella-

Plaintiff's Exhibit No. 11—(Continued)

tion) shall be returned to The Chase National Bank of the City of New York.

Each of the Secured Creditors hereby consents to the making by the Holding Company of the agreements set forth in this Article II and to any action taken by the Holding Company in conformity therewith; and The Chase National Bank of the City of New York agrees to release and deliver over the certificates representing the preferred and common stock of the Railroad Company now in its possession to the Holding Company when delivery of the same becomes necessary or appropriate to carry out said agreements.

III.

The agreements hereinabove contained shall not be effective until the agreements by the Holding Company, as owner of the outstanding preferred and common stock of the Railroad Company, in Article II hereof shall be approved by the requisite vote of the stockholders of the Holding Company, pursuant to the provisions of its Certificate of Incorporation and By-Laws; provided, however, that the Holding Company agrees to take such action immediately as may be necessary or appropriate to secure the requisite approval by vote of its stockholders. Performance of the agreements contained in Article I hereof shall be rendered by the Holding Company and each Secured Creditor, respectively, immediately upon such approval by vote of the stockholders of the Holding Company.

In Witness Whereof, each of the parties hereto

1688 *Western Pacific R.R. Corp., et al., vs.*

Plaintiff's Exhibit No. 11—(Continued)
has executed this agreement as of the 22nd day
of November, 1943.

THE WESTERN PACIFIC
RAILROAD CORPORATION,

By M. J. CURRY,
President.

[Corporate Seal]

Attest:

JOHN F. WIENKEN,
Secretary.

THE CHASE NATIONAL BANK OF THE
CITY OF NEW YORK,

By W. ARTHUR GROTZ,
Second Vice Pres.

[Corporate Seal]

Attest:

WM. MOHRMANN,
A. C.

CENTRAL HANOVER BANK
& TRUST COMPANY,

By R. G. COOMBE,
Vice-Pres.

[Corporate Seal]

Attest:

C. R. PARKER, JR.,
Ass't. Sec.

Plaintiff's Exhibit No. 11—(Continued)

JAMES FOUNDATION OF
NEW YORK, INC.,

By WILLIAM W. CARMAN,
President.

[Corporate Seal]

Attest:

CHARLES E. ANDREWS,
Asst. Secy.

REORGANIZATION COMMITTEE OF THE
WESTERN PACIFIC RAILROAD COM-
PANY,

F. H. ECKER.

FRANK C. WRIGHT,

ROBERT E. COULSON.

Plaintiff's Exhibit No. 11—(Continued)

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came M. J. Curry, to me known, who being by me duly sworn, did depose and say that he resides in New Rochelle, N. Y.; that he is President of The Western Pacific Railroad Corporation, one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by authority of the Board of Directors of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ MARY C. VALOUCH,
Notary Public,
Westchester County.

Commission expires March 30, 1945.

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came W. Arthur Gretz, to me known, who being by me duly sworn, did depose and say that he resides in Ridgewood, N. J.; that he is 2nd

Plaintiff's Exhibit No. 11—(Continued)

Vice Pres. of The Chase National Bank of the City of New York, one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation that the seal affixed to the said instrument is such corporate seal that it was so affixed by authority of the Board of Directors of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ HENRY P. SCHOERRY,

Notary Public,

Nassau County.

Commission expires March 30, 1944.

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came R. G. Coombe, to me known, who being by me duly sworn, did depose and say that he resides in Greenwich, Conn.; that he is Vice Pres. of Central Hanover Bank & Trust Company, one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by authority of the Board of

Plaintiff's Exhibit No. 11—(Continued)
Directors of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ DAVID McPHERSON,
Westchester Co. Notary.

Commission expires March 30, 1945.

State of New York,
County of New York—ss.

On this 24th day of November, 1943, before me personally came William W. Carman, to me known, who being by me duly sworn, did depose and say that he resides in Summit, N. J.; that he is President of James Foundation of New York, Inc., one of the corporations described in and which executed the foregoing instrument; that he knows the seal of the said corporation; that the seal affixed to the said instrument is such corporate seal; that it was so affixed by authority of the Trustees of the said corporation, and that he signed his name thereto by like authority.

[Notarial Seal]

/s/ JAMES YUILLE,
Notary Public,
Westchester County.

Commission expires March 30, 1945.

Plaintiff's Exhibit No. 11—(Continued)

State of New York,

County of New York—ss.

On this 23rd day of November, 1943, before me personally came Frederick H. Ecker, to me known and known to me to be the individual described in and who executed the foregoing instrument and acknowledged to me that he executed the same as a member and by the authority of the Reorganization Committee of The Western Pacific Railroad Company.

[Notarial Seal]

/s/ ALBERT V. ZIELFELDT,

Notary Public,

Bronx County.

Commission expires March 30, 1945.

State of New York,

County of New York—ss.

On this 24th day of November, 1943, before me personally came Frank C. Wright, to me known and known to me to be the individual described in and who executed the foregoing instrument and acknowledged to me that he executed the same as a member and by the authority of the Reorganization

1694 *Western Pacific R.R. Corp., et al., vs.*

Plaintiff's Exhibit No. 11—(Continued)
Committee of The Western Pacific Railroad Com-
pany.

[Notarial Seal]

/s/ DORIS C. THOMAS,

Notary Public, Queens Co.

Commission expires March 30, 1945.

State of New York,

County of New York—ss.

On this 23rd day of November, 1943, before me personally came Robert E. Coulson, to me known and known to me to be the individual described in and who executed the foregoing instrument and acknowledged to me that he executed the same as a member and by the authority of the Reorganization Committee of The Western Pacific Railroad Company.

[Notarial Seal]

/s/ BEATRICE C. CUNNINGHAM,

Notary Public,

New York County.

Commission expires March 30, 1944.

Plaintiff's Exhibit No. 11—(Continued)

Schedule A

Collateral Notes Bearing Interest at 5% Per Annum, Executed and Delivered by The Western Pacific Railroad Corporation to The Chase National Bank of the City of New York

Collateral Notes bearing interest at 5% per annum, executed and delivered by The Western Pacific Railroad Corporation to The Chase National Bank of the City of New York:

Date	Amount	Status as of Sept. 30, 1943
May 31, 1932	\$4,186,000.00	\$1,715,689.36
Dec. 8, 1941	4,521.00	4,521.00
Feb. 9, 1942	7,190.20	7,190.20
Mar. 10, 1943	1,642.16	1,642.16
Total principal indebtedness	\$4,199,353.36	\$1,729,042.72
Accrued and unpaid interest to September 30, 1943		1,991,179.90
Additional indebtedness for advances during 1943		1,546.35
Total indebtedness, principal and interest, as of September 30, 1943		\$3,721,768.97
Collateral held by The Chase National Bank of the City of New York, on September 30, 1943, as security for said collateral notes:		Approximate Market Value as of Sept. 30, 1943
	Face Amount	
The Denver and Rio Grande Western Railroad Company, General Mortgage Sinking Fund, 5% Gold Bonds, due 1955	\$2,792,000.00	\$ 153,560.00
The Denver and Rio Grande Western Railroad Company, Refunding and Improvement Mortgage, 6% Gold Bonds, Series A, due 1974	800,000.00	*320,000.00
	\$3,592,000.00	\$ 473,560.00

Not traded. Estimated by comparison with other bonds of the same Company which receive comparable treatment under the Plan of Reorganization of that Company.

Plaintiff's Exhibit No. 11—(Continued)

Schedule A—(Continued)

Securities sold by The Chase National Bank of the City of New York, prior to September 30, 1943, pursuant to the terms of the aforementioned collateral notes:

	Face Amount	
The Western Pacific Railroad Company, First Mortgage, 5% Gold Bonds, Series A, due 1946	\$4,464,000.00	Sold prior to Sept. 30, 1943
The Denver and Rio Grande Western Railroad Company, General Mortgage Sinking Fund, 5% Gold Bonds, due 1955	959,875.00	"
The Denver and Rio Grande Western Railroad Company, 6% Cumulative Preferred Stock \$100 par value	2,070,000.00	"
	<u>\$7,493,875.00</u>	

Schedule B

Statement of Indebtedness of The Western Pacific Railroad Corporation to Central Hanover Bank & Trust Company and of Collateral Previously Held by Central Hanover Bank & Trust Company

Collateral Notes executed and delivered by The Western Pacific Railroad Corporation to Central Hanover Bank & Trust Company:

	Principal Amount	Status as of Sept. 30, 1943
Note, dated May 25, 1932, at 5% on \$675,000 from January 31, 1934 to January 31, 1935, and on \$635,000 from January 31, 1935 to February 1, 1935, and at 4½% on \$635,000 from February 1, 1935 to January 31, 1942, at 4½% on \$623,751.14 from January 31, 1942, payable on demand	\$ 623,751.14	Principal paid by application of Proceeds of sale of collateral
Note, dated Dec. 1, 1941 at 4½%, payable on demand	671.00	"
Note, dated Jan. 30, 1942 at 4½%, payable on demand	1,067.16	"
Total Principal	<u>\$ 625,489.30</u>	

Plaintiff's Exhibit No. 11—(Continued)
Schedule B—(Continued)

Collateral sold by Central Hanover
Bank & Trust Company prior to Sept.
30, 1943:

	Face Amount	
The Western Pacific Railroad Company, First Mortgage, 5% Gold Bonds, Se- ries A, due 1946	\$1,242,000.00	Sold prior to Sept. 30, 1943
The Rio Grande Western Railway Com- pany, First Consolidated Mortgage, 4% Gold Bonds, due 1949	364,000.00	"
The Denver & Rio Grande Railroad Company, First Consolidated Mort- gage, 4% Gold Bonds, due 1936	10,000.00	"
Total	\$1,616,000.00	

Summary

Total net proceeds from sale of collat- eral	\$ 726,484.03	
Total principal amount of notes	625,489.30	
Balance	\$ 100,994.73	
Accrued unpaid interest as of March 24, 1943	\$ 269,151.03	
Balance of proceeds from sale of collat- eral applied to accrued unpaid inter- est	100,994.73	
Balance accrued unpaid interest, Sep- tember 30, 1943		<u>\$168,156.30</u>

Plaintiff's Exhibit No. 11—(Continued)

Schedule C

Statement of Indebtedness of The Western Pacific Railroad Corporation to James Foundation of New York, Inc. and of Collateral Held by James Foundation of New York, Inc. as Security Therefor,
As of September 30, 1943

Collateral notes bearing interest at 5% per annum, executed and delivered by The Western Pacific Railroad Corporation to Curtiss Southwestern Company, a Delaware Corporation, in 1931 and 1932, duly assigned and transferred by Curtiss Southwestern Company to the Estate of Arthur Curtiss James and by the Estate of Arthur Curtiss James to James Foundation of New York, Inc.:

Date	Amount	Status as of Sept. 30, 1943
July 1, 1931.....	\$1,475,000.00	\$1,475,000.00
July 27, 1931.....	920,000.00	920,000.00
Aug. 28, 1931.....	1,100,000.00	1,100,000.00
Nov. 25, 1931.....	880,000.00	880,000.00
Jan. 25, 1932.....	103,850.00	103,850.00
Total principal indebtedness....	\$4,478,850.00	\$4,478,850.00
Accrued and unpaid interest to September 30, 1943		2,156,193.94
Additional indebtedness for advances during 1940, 1941 and 1942		22,454.64
Total indebtedness, principal and interest, as of September 30, 1943		\$6,657,498.58
Collateral held by James Foundation of New York, Inc., on September 30, 1943, as security for said collateral notes:		Approximate Market Value as of Sept. 30, 1943
The Western Pacific Railroad Company First Mortgage, 5% Gold Bonds, Series A, due 1946	Face Amount	
	\$5,980,000.00	\$4,186,000.00
The Denver and Rio Grande Western Railroad Company, Refunding and Improvement Mortgage, 6% Bonds, Series A, due 1974	200,000.00	*80,000.00
The Western Realty Company, Common Stock, 3,005 shares, par value.....	300,500.00	**157,000.00
	\$6,480,500.00	\$4,423,000.00

* Not traded. Estimated by comparison with other bonds of the same Company which receive comparable treatment under the Plan of Reorganization of that Company.
** Appraised value as of February 15, 1943.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 12

Filed August 23, 1944.

In the District Court of the United States for the
Northern District of California, Southern Division.

No. 26591-S

In the Matter of

The Western Pacific Railroad Company,
Debtor.

PETITION OF REORGANIZATION COMMITTEE FOR AN ORDER APPROVING USE OF THE DEBTOR COMPANY IN CARRYING OUT AND MAKING EFFECTIVE THE PLAN, APPROVING PROPOSED AMENDMENTS TO THE ARTICLES OF INCORPORATION AND PROPOSED NEW BY-LAWS OF DEBTOR COMPANY AND APPROVING FORMS OF PREFERRED AND COMMON STOCK CERTIFICATES AND DIRECTING ACTION WITH RESPECT THERETO

Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, being all the members of the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, hereby represent to the Court and petition as follows:

1. The plan of reorganization of the debtor (herein after called "the plan"), confirmed by order of

Plaintiff's Exhibit No. 12—(Continued)

this Court on October 11, 1943, provides in subdivision R that "The plan may be carried out either by revesting the properties formerly of the debtor in the debtor company or by transferring said properties to a new corporation organized for the purpose," and "The method of carrying out the plan shall be determined by the reorganization committee in its discretion," subject to the approval of the Court. Under subdivision R of the plan your petitioners are empowered also to determine, subject to the approval of the Court, the form and, except as otherwise provided in the plan, the provisions of the charter, by-laws and stock certificates of the reorganized company.

2. The debtor company, The Western Pacific Railroad Company, is a corporation already organized and existing under the laws of the State of California, and has certain rights, privileges and franchises in the states of California, Nevada and Utah, and has the record title to the railroad facilities and properties involved in the bankruptcy proceeding; and the use of the debtor company in carrying out the plan will result in substantial economies and will otherwise facilitate the reorganization. After considering all factors, your petitioners have determined, acting on advice of counsel, that the debtor company should be used in carrying out the plan and that a new corporation should not be organized.

3. Pursuant to the petition of the Reorganization Committee filed herein December 1, 1943, the

Plaintiff's Exhibit No. 12—(Continued)

Court on December 17, 1943, entered an order authorizing and directing transfer of the preferred and common stock of the debtor company to the Reorganization Committee, at a time and place to be fixed in the discretion of the Committee by its request in writing to The Western Pacific Railroad Corporation, a Delaware corporation which previously owned such stock, and approving action of the Committee in connection with a certain agreement for securing control of such stock. The transfer by The Western Pacific Railroad Corporation of the preferred and common stock of the debtor company was duly approved by the requisite vote of the stockholders of The Western Pacific Railroad Corporation, pursuant to the provisions of its Certificate of Incorporation and By-laws on April 20, 1944. Thereafter, on the first day of May, 1944, your petitioners, pursuant to said order of December 17, 1943, made request of The Western Pacific Railroad Corporation for the transfer of said stock in accordance with the authorization of its stockholders and on the same date said stock was duly transferred to your petitioners. Said transfer has been made of record on the books of the debtor company, except as to directors' qualifying shares, certificates for which, duly endorsed in blank, are held by the Reorganization Committee, by the issuance of new preferred and common stock certificates to your petitioners.

4. In order that the debtor company may be used in carrying out and making effective the plan, it

Plaintiff's Exhibit No. 12—(Continued)

will be necessary to amend its Articles of Incorporation and to adopt new By-laws to provide for the new preferred and common stock authorized under the plan and for other changes required by said plan. Your petitioners, subject to the approval of the Court, have approved a proposed Certificate of Amendment of the Articles of Incorporation of the debtor company and proposed new By-laws of the debtor company. Copies of said proposed Certificate of Amendment and By-laws in typewritten form are annexed hereto as Exhibits "A" and "B", and are hereby submitted to the Court for approval as to substance and, also, as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable.

5. Your petitioners, subject to the approval of the Court, have also approved in draft form the face of a proposed certificate for shares of the Preferred Stock, Series A, provided under the plan, and the face of a proposed certificate for shares of the Common Stock, likewise so provided, copies of which are annexed hereto as Exhibits "C" and "D," respectively, and are hereby submitted to the Court for approval as to substance and general form. Your petitioners have also approved the reproduction, on the reverse side of each of said stock certificates, of the full text of Article VII of the Articles of Incorporation of the debtor company, after amendment, as shown in the proposed Certificate of Amendment; Exhibit "A", annexed hereto. Inasmuch as the re-

Plaintiff's Exhibit No. 12—(Continued)

verse side of each of said stock certificates will include only the usual form of assignment and the text of said Article VII, which is subject to the approval of the Court as a part of said Exhibit "A", it is deemed unnecessary to submit the forms of the reverse sides of said certificates in draft form.

6. Your petitioners propose, in the event the Court approves the exhibits hereto annexed, to take appropriate action, as the record holders of the present preferred and common stock of the debtor company for the adoption of the proposed By-laws for the debtor company and the proposed amendment to its Articles of Incorporation and to arrange for the preparation of new preferred and common stock certificates, in temporary form, if your petitioners shall determine this to be necessary or advisable, and in permanent engraved form. Your petitioners also propose to request the then directors of the debtor company to take such appropriate action as is required of directors in connection with the adoption of said amendments. It is proposed that the adoption of said amendments to the Articles of Incorporation shall be subject to the further order of the Court as to the time of the filing of the Certificate of Amendment with the Secretary of State of California which will be required in order to make the amendments completely effective.

Wherefore, your petitioners pray for the order of this Court:

(a) Approving the determination of your petitioners that the existing debtor company, The West-

Plaintiff's Exhibit No. 12—(Continued)
ern Pacific Railroad Company, be used in carrying out and making effective the plan of reorganization;

(b) Approving the proposed Certificate of Amendment of the Articles of Incorporation of the debtor company, a copy of which in typewritten form is attached hereto as Exhibit "A", as to substance and, also, as to form, subject to such minor changes as the Reorganization Committee, upon advise of counsel, may deem advisable;

(c) Approving the proposed By-laws for the debtor company, a copy of which in typewritten form is attached hereto as "Exhibit B", as to substance and, also, as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(d) Approving the substance and the general form of the proposed face of the certificate for shares of Preferred Stock, Series A, which is attached hereto as "Exhibit C";

(e) Approving the substance and the general form of the proposed face of the certificate for shares of common stock, which is attached hereto as "Exhibit D";

(f) Authorizing and directing petitioners, as the Reorganization Committee of the debtor company, and as stockholders of record of the debtor company, to take or cause to be taken such action as may be necessary or appropriate for the adoption of said proposed amendments to the Articles of Incorporation and said proposed By-laws of the debtor com-

Plaintiff's Exhibit No. 12—(Continued)

pany, and for the preparation of complete certificates as described herein for the preferred and common stock contemplated under the plan of reorganization, in temporary form if the petitioners shall determine this to be necessary or advisable, and in permanent form;

(g) Authorizing the directors of the debtor company then in office to take such action, as and when requested by the Reorganization Committee, as may be necessary and appropriate in connection with the adoption of said amendments to the Articles of Incorporation.

(h) Granting such other and further relief as may be proper in the premises.

Respectfully submitted,

WHITMAN, RANSOM,
COULSON & GOETZ

PILLSBURY, MADISON
& SUTRO

Counsel for Petitioners.

[Verification omitted in printing]

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 13

Filed Sept. 25th, 1944.

In the District Court of the United States for the
Northern District of California, Southern Division.

No. 26591-S

In the Matter of
The Western Pacific Railroad Company,
Debtor.

ORDER APPROVING USE OF THE DEBTOR
COMPANY IN CARRYING OUT AND MAK-
ING EFFECTIVE THE PLAN, APPROV-
ING PROPOSED AMENDMENTS TO THE
ARTICLES OF INCORPORATION AND
PROPOSED NEW BY-LAWS OF DEBTOR
COMPANY AND APPROVING FORMS OF
PREFERRED AND COMMON STOCK CER-
TIFICATES AND DIRECTING ACTION
WITH RESPECT THERETO

The petition filed August 23, 1944 by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, for an order approving the use of the debtor company in carrying out and making effective the plan, approving proposed amendments to the articles of incorporation and proposed new by-laws of the debtor company and approving forms of preferred and common stock certificates and di-

Plaintiff's Exhibit No. 13—(Continued)

recting action with respect thereto, duly came on to be heard and was heard on the 25th day of September, 1944, and has been submitted.

The Court being fully advised in the premises finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court, dated and filed August 23, 1944, and that all of the allegations and representations contained in the petition are true.

The Court further finds and concludes:

(a) That the corporate existence of the debtor and its authority to do business in the states of California, Nevada and Utah has been duly maintained and preserved and that the preferred and common stock of the debtor is held of record by the petitioners herein so as to make said company available for use as the reorganized company in carrying out and making effective the plan of reorganization;

(b) That the use of the debtor company as the reorganized company under the plan of reorganization, as determined and proposed by the petitioners herein, will result in substantial economies and otherwise facilitate the reorganization and should be approved;

(c) That the proposed Certificate of Amendment of the Articles of Incorporation of the debtor company and the amendments to said Articles contained therein are consistent with the plan of reorganization and appropriate for its purposes, and should be approved;

Plaintiff's Exhibit No. 13—(Continued)

(d) That the proposed new By-laws of the debtor company are consistent with the plan of reorganization and appropriate for its purposes, and should be approved;

(e) That the proposed forms of certificates for shares of new Preferred Stock, Series A, and shares of new common stock, as described in said petition, to which are attached as exhibits draft forms of the faces of said certificates, are consistent with the plan or reorganization and appropriate for its purposes, and should be approved; and

(f) That the action proposed to be taken by the petitioners herein, as the record holders of the stock of the debtor company and as the Reorganization Committee under the plan of reorganization, and by the directors of said company then in office, should be authorized.

Now, Therefore, it is hereby Ordered, Adjudged and Decreed:

(1) That the use of the existing debtor company in carrying out and making effective the plan of reorganization, as determined and proposed by the petitioners herein, be and hereby is approved;

(2) That the Certificate of Amendment of the Articles of Incorporation of the debtor company and the amendments to said Articles contained

Plaintiff's Exhibit No. 13—(Continued)

therein, being Exhibit A attached to said petition, be and hereby are approved as to the substance and provisions thereof and as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(3) That the By-laws for the debtor company, being Exhibit B attached to said petition, be and hereby are approved as to the substance and provisions thereof and as to form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(4) That the form of certificate for shares of Preferred Stock, Series A, being the form described in said petition, the face of which in draft form was submitted therewith as Exhibit C, be and hereby is approved as to the substance and provisions thereof and as to general form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(5) That the form of certificate for shares of common stock, being the form described in said petition, the face of which in draft form was submitted therewith as Exhibit D, be and hereby is approved as to the substance and provisions thereof and as to general form, subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

Plaintiff's Exhibit No. 13—(Continued)

(6) That the petitioners herein, as the Reorganization Committee under the plan of reorganization and the stockholders of record of the debtor company, be and hereby are authorized and directed to take or cause to be taken such action as may be necessary or appropriate for the adoption of the aforesaid amendments to the Articles of Incorporation and new By-laws of the debtor company and for the preparation of complete certificates as described in said petition for the preferred and common stock contemplated under the plan or reorganization, in temporary form if petitioners shall determine these to be necessary or advisable and in permanent form; and

(7) That the directors of the debtor company then in office be and hereby are authorized to take such action as and when requested by the petitioners herein as said Reorganization Committee, as may be necessary or appropriate in connection with the adoption of the aforesaid amendments to the Articles of Incorporation of the debtor company.

Dated, September 25, 1944.

A. F. St. SURE,
District Judge.

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 14

[Plaintiff's Exhibit No. 14 is identical to Exhibits 1, "A", "B", "C", "D", "E", and "F" attached to the Answer and Counterclaim of Defendants Western Pacific Railroad Co., et. al. See printed pages 36 to 108 of Volume 1.]

— — — —

PLAINTIFF'S EXHIBIT No. 15

Whereas, heretofore in a proceeding in the United States District Court for the Northern District of California, Southern Division, for the reorganization of a railroad under Section 77 of the Bankruptcy Act, as amended, entitled "In the Matter of The Western Pacific Railroad Company, Debtor", No. 26591-S, a Plan of Reorganization of The Western Pacific Railroad Company was approved and confirmed, and, pursuant to the provisions of said Plan of Reorganization, an order was entered on September 25, 1944, by said Court approving the use of the said debtor company, The Western Pacific Railroad Company, a corporation organized and existing under the laws of the State of California, as the reorganized company in carrying out said plan;

Whereas, the Interstate Commerce Commission, under date of October 24, 1944, in Docket #10913, made a report and order which, among other things, approved and authorized the assumption by said The Western Pacific Railroad Company of obligations and liabilities as provided in said plan;

Plaintiff's Exhibit No. 15—(Continued)

Whereas, pursuant to said Plan of Reorganization and to the order entered in said proceeding on November 27, 1944, T. M. Schumacher and Sidney M. Ehrman, as Trustees of the property of said The Western Pacific Railroad Company, duly appointed in said proceeding (hereinafter called the "Trustees"), have, by deed dated December 9th, 1944, remised, released, transferred, conveyed and quitclaimed to the undersigned, said The Western Pacific Railroad Company, all of the property, real, personal and mixed, of every kind and nature, vested in, held, possessed, used or controlled by said Trustees;

Now, Therefore, pursuant to the provisions of said order entered November 27, 1944, and in consideration of the said release, transfer and conveyance by the Trustees, the undersigned The Western Pacific Railroad Company, for itself, its successors and assigns, makes this Agreement with said Trustees, for the benefit of said Trustees and of all other parties in interest in the above-entitled proceedings, under which agreement the undersigned does hereby:

1. Assume and agree to perform all contracts, leases and agreements made or entered into by the debtor in possession or by said Trustees and remaining in effect on December 31, 1944, and all contracts, leases and agreements of the debtor in effect on August 2, 1935, either assumed or not disaffirmed by said Trustees, which remain in effect on December 31, 1944, and expenses of reorganization allowed by

Plaintiff's Exhibit No. 15—(Continued)

the Court within the maximum fixed by the Interstate Commerce Commission;

2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees and without limitation thereto, any and all liabilities or obligations of the debtor in possession or said Trustees with respect to claims for personal injury or death, for loss or damage to property and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944.

3. Without limitation of the generality of the foregoing agreements in paragraphs 1 and 2 hereof, specifically undertake to defend at its own sole cost and expense all suits and proceedings, of whatsoever character, now or hereafter instituted against the Trustees, or either of them, arising out of the possession, use or operation of the debtor's properties by the Trustees or of their conduct of the debtor's business, and to assume the conduct of all suits and proceedings, of whatsoever character, heretofore or hereafter brought by the Trustees in the discharge of their duties and responsibilities as such, and, generally, to indemnify the Trustees and save them harmless against all expense, liability, loss, judgments, claims and demands arising out of such suits

Plaintiff's Exhibit No. 15—(Continued)

or proceedings. It is the intent of the covenants in this paragraph 3 contained that The Western Pacific Railroad Company shall assume responsibility for all such suits and proceedings to which the Trustees, or either of them, are or shall become parties, to the same effect as if The Western Pacific Railroad Company instead of the Trustees had been party thereto in the first instance.

4. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, specifically assume and agree to perform the obligations of the Trustees in respect of the following:

(a) \$1,235,000 unpaid balance, principal amount of Three Per Cent. Equipment Trust Certificates, Series of 1937, issued February 1, 1937, under Agreement of same date, between J. T. Harrigan and F. E. Egly, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(b) \$1,855,000 unpaid balance, principal amount of One and Three Quarters Per Cent Equipment Trust Certificates, Series of 1941, issued August 1, 1941, under Agreement of same date, between M. J. Suydam and F. W. Walter, Vendors, with Central Hanover Bank and Trust Company, Trustee, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor.

(c) Conditional Sale Agreement, dated as of

Plaintiff's Exhibit No. 15—(Continued)

May 25, 1943, between Lima Locomotive Works, Incorporated, and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six steam freight locomotives.

(d) Conditional Sale Agreement, dated as of June 21, 1943, between Electro-Motive Division, General Motors Corporation and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of three 5400 H. P. diesel electric freight locomotives.

(e) Conditional Sale Agreement, dated as of June 1, 1944, between The Chase National Bank of the City of New York and T. M. Schumacher and Sidney M. Ehrman, Trustees of the Property of The Western Pacific Railroad Company, Debtor, relating to the purchase on monthly installment plan of six 5400 H. P. diesel electric freight locomotives.

5. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, specifically assume and agree to pay in cash the face amount of any and all outstanding first mortgage bond coupons which matured on or prior to September 1, 1933, and had not theretofore been presented for payment; such coupons being those which the Court by orders of March 11, 1936 and March 20,

Plaintiff's Exhibit No. 15—(Continued)

1936, authorized The Chase National Bank of the City of New York to pay from funds which had been deposited with it by the debtor:

6. Without limitation of the generality of the foregoing agreements in Paragraphs 1 and 2 above, assume the liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945, whether or not proof thereof was made in the said proceeding and without prejudice by reason of such proof not having been made.

This agreement shall become effective on December 29, 1944, at 12:01 A. M., Pacific War Time.

In Witness Whereof, the undersigned has caused this instrument to be executed in its behalf by its President and its corporate seal to be hereunto affixed this 14th day of December, 1944.

THE WESTERN PACIFIC
RAILROAD COMPANY,

[Corporate Seal] By CHARLES ELSEY,
President.

Attest:

C. L. DROIT,
Secretary.

[Endorsed]: Filed Feb. 1, 1949.

THE WESTERN PACIFIC RAILROAD CORPORATION
Schedule of Preferred and Common Stockholders of Record
September 11, 1935 -- September 16, 1947

<u>Name</u>	<u>September 11, 1935</u>	<u>March 10, 1936</u>	<u>September 15, 1937</u>	<u>September 15, 1938</u>	<u>September 13, 1939</u>	<u>September 11, 1940</u>	<u>September 17, 1941</u>	<u>September 16, 1942</u>	<u>November 27, 1943</u>	<u>September 13, 1944</u>	<u>September 12, 1945</u>	<u>September 11, 1946</u>	<u>September 16, 1947</u>
Arthur Curtiss James	7000 C	7000 P	7000 C	7000 C	7000 C	7000 C	7000 C	7000 C					
Curtiss Southwestern Corporation	310690 C	310690 P	310690 C	310690 C	310690 C	310690 C	310690 C	310690 C	310690 C	310690 C	310690 C	310690 C	310690 C
Curtiss Southwestern Company	30700 C	30700 P	30700 C	30700 C	30700 C	30700 C	30700 C	30700 C					
O. C. James Co.													
Estate of Arthur Curtiss James, deceased								40700 C	40700 C	40700 C	40700 C	40700 C	40700 C
James Foundation of New York, Inc.								26640 P	26640 P	26640 P	26640 P	26640 P	26640 P
<u>Directors and Officers</u>													
Robert S. Brewster	500 C	500 C	500 C	500 C									
T. M. Schumacher	1000 P	1000 P	1000 P	1000 P									
Arthur Curtiss James (see above)	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C
E. Hayward Perry	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C
William M. Kingsley	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C
William W. Carman	100 P	100 P	100 P	100 P	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C
M. J. Curry	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C
Arthur W. Loasby	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C
Finley J. Shepard	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C
Robert E. Coulson	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C
Alexander Berger	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C	20 C
Willis D. Wood	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C
J. E. Olyphant, Jr.	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C
A. Perry Osborn	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C
R. Marshall Price	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C	100 C
John F. Wicken								10 P	10 C	10 C	10 C	10 C	10 C
William W. Hutton								10 P	10 C	10 C	10 C	10 C	10 C
C. C. Sheehan								10 P	10 C	10 C	10 C	10 C	10 C
M. C. Valouch								10 P	10 C	10 C	10 C	10 C	10 C
F. C. Nicodemus, Jr.								10 P	10 C	10 C	10 C	10 C	10 C
H. Brum Campbell						10 C	10 C	10 C	10 C	10 C	10 C	10 C	10 C
<u>Total Outstanding, Preferred</u>	381250	381250	381250	381250	381250	381250	381250	381250	381250	381250	381250	381250	381250
<u>Total Outstanding, Common</u>	574501	574501	574501	574501	574501	574501	574501	574501	574501	574501	574501	574501	574501

C = Common Shares
P = Preferred Shares

Source: Certified List of Common and Preferred Stockholders
prepared by Transfer Agent of The Western Pacific
Railroad Corporation for use at stockholders' meetings

2650828
17
FL 11212
2650828

PLAINTIFF'S EXHIBIT No. 18

1718

Securities of Western Pacific Railroad Company

No. 1

Owned by	1935	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947
1st Mortgage 5% Bonds due 1946													
Arthur Curtiss James	\$148,000	\$647,000	\$2,384,000	\$2,964,000	\$3,000,000	\$3,000,000							
Curtiss Southwestern Company	14,000	14,000	14,000	14,000	14,000	14,000							
Curtiss Southwestern Corporation					1,000,000	1,000,000	\$1,000,000	\$1,000,000					
A. C. James Co.					None								
Estate of Arthur Curtiss James						3,014,000	3,014,000						
James Foundation of New York Inc.								\$2,880,000	\$8,860,000		Exchanged for new securities 12/29/44		
3 Year 5% Collateral Notes													
A. C. James Co.	\$1,999,800	\$1,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	\$4,999,800	Exchanged for new securities 12/29/44		
Collateralized by:—													
\$6,249,500 W.P.R.R. Co. 5% Genl. & Ref. Bonds due 1957													
Less 2,000,000 Delivered to Railroad Credit Corpn. 3/24/33 on which A.C.J. Co. held second lien													
<hr/> \$4,249,500													
4½% Income Mortgage (Convertible) Bonds due 2014													
James Foundation of New York Inc.											\$3,544,000		
A. C. James Co.											163,680		
5% Preferred Stock													
James Foundation of New York Inc.											\$53,160	\$55,727	\$55,727
A. C. James Co.											2,567		
Common Stock													
James Foundation of New York Inc.											\$41,376 1/5	\$153,165 1/5	\$153,165 1/5
A. C. James Co.											37,635		

[Endorsed]: Filed Feb. 1, 1949.

PLAINTIFF'S EXHIBIT No. 22

The Western Pacific Railroad Corporation
Schedule of Directors
August 1, 1935 to February 9, 1948

Name	8/1/35	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946	1947	2/9/48
R. S. Brewster	X	R-11/17/36												
T. M. Schumacher	X	X	X	X	X	X	X	X	X	X	X	X	X	X
A. C. James	X	X	X	X	R-12/31/39									
E. H. Ferry	X	R-10/6/36												
W. M. Kingsley	X	X	X	X	X	X	X	D-9/7/42						
W. W. Carman	X	X	X	X	X	X	X	R-2/1/42						
M. J. Curry	X	X	X	X	X	X	X	X	X	X	X	X	X	X
A. W. Loasby	X	D-11/24/36												
F. J. Shepard	X	X	X	X	X	X	X	D-8/22/42						
R. E. Coulson	X	X	X	X	X	X	X	R-2/6/42						
A. Berger	X	X	X	X	X	D-4/11/40								
W. D. Wood	X	X	X	X	X	X	X	X	X	X	X	X	X	X
J. K. Olyphant, Jr.			E-1/7/37	X	X	X	R-12/18/41							
A. P. Osborn			E-1/7/37	X	X	X	X	X	X	X	X	X	X	X
R. M. Price			E-1/7/37	X	X	X	D-4/7/41							
H. B. Campbell					E-7/5/40	X	X	X	X	X	R-5/1/45			
J. F. Wienken								E-4/29/42	X	X	X	R-4/25/46		
W. W. Hatton								E-9/23/42	X	X	X	X	X	X
G. C. Sheehan										E-2/15/44	X	R-10/10/46		
M. C. Valouch											E-5/1/45	X	X	X
F. C. Nicodemus, Jr.												E-10/10/46	X	X

E—Elected

R—Resigned

D—Deceased

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 23

The Western Pacific Railroad Corporation
 Schedule of Payments Made to Officers, Counsel and Employees
 August 1, 1935 to December 31, 1946

Name	Aug. 1, 1935- 12/31/35	1936	1937	1938	1939	1940	1941	1942	1943	1944	1945	1946
T. M. Schumacher, President	\$10,416.65	\$25,000.00	\$25,000.00	\$25,000.00	\$15,000.00	\$15,000.00	\$15,000.00					
M. J. Curry, President-Treasurer....								\$4,125.00	\$1,875.00			
M. J. Curry, Secretary-Treasurer....	2,250.00	5,400.00	5,400.00	5,400.00	3,300.00	3,300.00	3,300.00	275.00				
M. J. Curry—Expenses	225.68	531.08	433.47	353.92	378.28	366.21	216.13	7.85	47.96	\$115.83	\$ 78.19	\$ 79.15
H. Brua Campbell, Counsel*	2,083.30	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	5,000.00	2,500.00	1,041.65			6,000.00
H. Brua Campbell, Counsel—exp.*											1,935.82	
John F. Wienken, Secretary								916.63	416.65			
John F. Wienken					87.50	525.00	525.00	43.75			250.00	
C. E. Andrews	1,083.30	2,600.00	2,600.00	2,600.00	741.84							
W. C. Mittelberg	937.50	2,250.00	2,250.00	2,250.00	920.00							
J. M. Pugh					358.17	750.00	750.00					
M. C. Valouch	312.50	750.00	810.00	810.00	340.00	340.00	340.00	340.00	141.65			
Lillian O'Neill					260.00	260.00	260.00	260.00	108.30			
C. C. Sheehan	250.00	600.00	660.00	660.00	240.00	240.00	240.00	240.00	100.00			
Thomas Keeley (D&RGW reorg.)						112.62						
Whitman, Ransom, Coulson & Goetz (tax matter)				1,335.96								
Sloss & Turner (WPRR reorg.)							431.35		62.20			
W. V. Hodges (D&RGW reorg.)									750.00	750.00		
Leroy Goodrich											428.40	3,000.00
Marshall, All, Carey & Doub												6,000.00

* Payments made to Pierce & Greer and F. C. Nicodemus, Jr. included in this item.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 24

The Western Pacific Railroad Corporation
Schedule of Payments Made to Pierce and Greer,
or H. Brua Campbell

January 1, 1942 — December 31, 1945

1942

February	Services for January, 1942	\$ 208.33
February	Services for February, 1942	208.33
March	Services for March, 1942.....	208.33
April	Services for April, 1942	208.33
May	Services for May, 1942	208.33
June	Services for June, 1942	208.33
July	Services for July, 1942	208.33
August	Services for August, 1942	208.33
September	Services for September, 1942	208.33
October	Services for October, 1942	208.33
November	Services for November, 1942	208.33
December	Services for December, 1942	208.33

Total.....	\$2,499.96
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1943

January	Services for January, 1943	\$ 208.33
October	Services for February-May 1943, incl.	833.33

\$1,041.66

1944

None

1945

August	Expenditures re: reorganization proceedings.....	\$1,935.82
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PLAINTIFF'S EXHIBIT No. 26

The Western Pacific Railroad Company

Ballot

(For straight voting)

Special Meeting of Stockholders, March 26, 1945.

The undersigned hereby vote(s) 134,738 shares of stock for the following-named persons to serve as directors until the annual meeting of stockholders:

Wakefield Baker	J. A. Folger
Edward H. Bell	Harry C. Hagerty
Edward G. Buckland	Charles B. Henderson
J. Reuben Clark, Jr.	J. W. Mailliard, Jr.
Robert E. Coulson	E. W. Mason
Charles Elsey	

Proxies filed

JAMES FOUNDATION OF
NEW YORK, INC.,

A. C. JAMES CO.

By /s/ ROBERT E. COULSON

ROBERT E. COULSON

Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write

“Proxies filed” on the first line and sign on the next line or lines.

The Western Pacific Railroad Company

Ballot

(For straight voting)

Annual Meeting of Stockholders, June 27, 1945.

The undersigned hereby vote(s) 134,738 shares of stock for the following-named persons to serve as directors until the next annual meeting of stockholders:

Wakefield Baker	J. A. Folger
Edward H. Bell	Harry C. Hagerty
Edward G. Buckland	Charles B. Henderson
J. Reuben Clark, Jr.	J. W. Mailliard, Jr.
Robert E. Coulson	E. W. Mason
Charles Elsey	

Proxies filed

JAMES FOUNDATION
OF NEW YORK, INC.

A. C. JAMES CO.

By /s/ ROBERT E. COULSON
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or

lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write "Proxies filed" on the first line and sign on the next line or lines.

The Western Pacific Railroad Company

Ballot

(For straight voting)

Annual Meeting of Stockholders, June 26, 1946.

The undersigned hereby vote(s) 208,892 shares of stock for the following-named persons to serve as directors until the next annual meeting of stockholders:

Wakefield Baker	Harry C. Hagerty
Edward H. Bell	Charles B. Henderson
J. Reuben Clark, Jr.	Stuart Jenkins
Robert E. Coulson	J. W. Mailliard, Jr.
Charles Elsey	E. W. Mason
James A. Folger	

Proxies filed

JAMES FOUNDATION OF
NEW YORK, INC.

By /s/ ROBERT E. COULSON
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or

lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write "Proxies filed" on the first line and sign on the next line or lines.

The Western Pacific Railroad Company

Ballot

(For straight voting)

Annual Meeting of Stockholders, June 25, 1947.

The undersigned hereby vote(s) 208,892 shares of stock for the following-named persons to serve as directors until the next annual meeting of stockholders:

Wakefield Baker	Harry C. Hagerty
Edward H. Bell	Charles B. Henderson
J. Reuben Clark, Jr.	Stuart Jenkins
Robert E. Coulson	J. W. Mailliard, Jr.
Charles Elsey	H. A. Mitchell
James A. Folger	

Proxies filed from

JAMES FOUNDATION OF
NEW YORK, INC.

By /s/ ROBERT E. COULSON and
STUART JENKINS,
Proxy or Proxies.

Note: If a stockholder votes personally, his signature must be placed on the first line. If the ballot is cast by proxy or proxies, the name of the stockholder must be signed on the first line and the name(s) of the proxy or proxies on the next line or

lines. If several stockholders are represented by proxy or proxies, such proxy or proxies may write "Proxies filed" on the first line and sign on the next line or lines.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 27

Statement No. 1

Sheet 4 of 4 Sheets

Summary

Statements of M. J. Curry, Asst. Treas. Covering Balances, Receipts and Expenditures of W.P. RR. Co. Funds by New York Office for Period—March 15, 1943, to May 1, 1945

	Balances and Receipts
On hand Mar. 1, 1943	\$ 2,224.96
Received Mar. 16, 1943, to Dec. 17, 1943....	40,700.00 \$ 42,924.96
Received Jan. 14, 1944, to Dec. 19, 1944....	50,800.00
Received Jan. 22, 1945, to Apr. 19, 1945....	14,500.00
Receipts other than W.P. RR. Co. Remittances	348.85
Total Balance and Receipts	<u>\$108,573.81</u>

	Disbursements
Expended March to Dec. 1943	\$40,836.11
Expended January to Dec. 1944	51,474.69
Expended January to May 1945	14,872.82
Total Expended by M. J. Curry	<u>\$107,183.62</u>
Unexpended Balance Returned to E. C. Bates, Treas., June 1945.....	<u>\$ 1,390.19</u>

Office of General Auditor
San Francisco, California
March 31, 1948

[Endorsed]: Filed Feb. 2, 1949.

PERIOD MARCH 16, 1943 TO MAY 1, 1943

1730

Page 1043

Mr. W. J. CURRY, ASST. TREAS.
Statement of Funds on hand and received; Bal. on hand March 1, 1943
Receipts: U. S. Notes, Treas. San Francisco to W. J. Curry, Asst. Treas.
Amount of Receipts
Disbursements for Individuals and Companies for transfers and exchanges
of W. J. Curry, U. S. First Mortgage Bonds
Total on hand and received by W. J. Curry - Mar. 1, 1943 to Dec. 31, 1943

PER MONTHLY STATEMENTS OF W. J. CURRY, ASST. TREAS. COVERED DISBURSEMENTS
BY NEW YORK OFFICE

Mr. W. J. Curry - Salary
- Expenses
Mr. W. Campbell - Salary
- Expenses
Mr. C. Taloush - Salary
- Expenses
J. F. Winstead - Salary
William O'Neill - Salary
Cellulose Sheehan - Salary
De W. H. Co. - Salary
Always Johnson - Salary
Stewart-Buchanan & Will - Fidelity Bond - W. J. Curry
Telephone Expense - W. J. Curry
Class National Bank - Office Rent
- Electricity
Regent House Service
General Manager B. T. Co. - Paying Int.
- Cremation Coupons
U. S. Telephone Expense
Delmonte Bros. Staty.
Cry. Spas. Water Co. - Water
American Bank Note Co. - Watering Bonds
United States Frg. Corp. - Staty.
H. K. Brewer & Co. - Staty.
Stid & Paves Corp. - Expenses
Fidelity Bond - N.B. Securities Service
Fidelity Bond - Equip. Repair
Bull. Ry. Pub. Co. Official Guide
Langdon Co. - Photostats
New York Telephone Co. Service
Ass. Mail Service - Mail Service
Hollis Express Agency
Chase Nat. Bank - Services Bk. Tr. 5/1/40
Flooded Warehouses - Warehouse
Royal Typewriter Co. - Equip. Repair
Himms-Bearman Pub. Co. - Sub. Ry. Age
Royal Typewriter Co. - Ribbons
Wholesale Co. - Sub. to American Letters
Hoddy, Investors - Services
City of New York - Occupancy Tax
Lafayette Bros. & Montgomery - C.P.A. Service
Wall Street Journal - Advertising
New York Times
A. B. Reule Co. - Subscript. Who's Who
Dept. of Documents - Govt. Manual, etc.
Wall Street Journal - Business Car Supplies
Wall Street Journal - Subscription
Hollis Express Agency - Pocket List RE Officials
Adams-Graham Division - Plates
- Stationery
Treas. of U.S.A. - Equip. Repair
Traffic Service Corp. - Subscriptions
Christmas Contribution to Rldg. Employees

MONTH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER	TOTAL
(A)										
Mr. W. J. Curry	\$2,254.00									\$2,254.00
Mr. W. Campbell	3,600.00	3,600.00	4,000.00	4,800.00	4,400.00	4,600.00	4,800.00	4,000.00	4,800.00	\$40,700.00
Mr. C. Taloush										150.00
J. F. Winstead										\$40,700.00
William O'Neill										
Cellulose Sheehan										
De W. H. Co.										
Always Johnson										
Stewart-Buchanan & Will										
Telephone Expense										
Class National Bank										
Regent House Service										
General Manager B. T. Co.										
U. S. Telephone Expense										
Delmonte Bros. Staty.										
Cry. Spas. Water Co.										
American Bank Note Co.										
United States Frg. Corp.										
H. K. Brewer & Co.										
Stid & Paves Corp.										
Fidelity Bond										
Fidelity Bond - N.B. Securities Service										
Fidelity Bond - Equip. Repair										
Bull. Ry. Pub. Co. Official Guide										
Langdon Co. - Photostats										
New York Telephone Co. Service										
Ass. Mail Service - Mail Service										
Hollis Express Agency										
Chase Nat. Bank - Services Bk. Tr. 5/1/40										
Flooded Warehouses - Warehouse										
Royal Typewriter Co. - Equip. Repair										
Himms-Bearman Pub. Co. - Sub. Ry. Age										
Royal Typewriter Co. - Ribbons										
Wholesale Co. - Sub. to American Letters										
Hoddy, Investors - Services										
City of New York - Occupancy Tax										
Lafayette Bros. & Montgomery - C.P.A. Service										
Wall Street Journal - Advertising										
New York Times										
A. B. Reule Co. - Subscript. Who's Who										
Dept. of Documents - Govt. Manual, etc.										
Wall Street Journal - Business Car Supplies										
Wall Street Journal - Subscription										
Hollis Express Agency - Pocket List RE Officials										
Adams-Graham Division - Plates										
- Stationery										
Treas. of U.S.A. - Equip. Repair										
Traffic Service Corp. - Subscriptions										
Christmas Contribution to Rldg. Employees										

Less Taxes included in salary payments above, withheld and paid to U. S. Treasury
by W. J. Curry, Co. San Francisco -
- Railroad Retirement Tax
- Federal Income Tax

Gross disbursements by W. J. Curry
Less amounts included in above disbursements, recovered by W. J. Curry, as follows:
BANK RE. Prop. of office rent covering space for transfer Agent, commencing
June 1, 1943 @ \$75.00 per Mo.
Refund of deposit by U. S. Post Office as guarantee of postage due on business reply
envelopes

Telephone tolls chargeable to other individuals
Mr. W. J. Curry
Mr. W. J. Curry, Asst. Treas. Statement Bal. on hand Dec. 31, 1943

(A) Since total expenditures for March 1943 are inseparable as to periods, Mar. 1 to 16 and Mar. 16 to 31,
(B) Balances made by check, drawn on W. J. Curry, Co. Funds in Bank of California, San Francisco, in favor of W. J. Curry, Asst. Treas., and
transmitted by U.S. Mail to W. J. Curry, for deposit to credit of W. J. Curry, Co. with Chase National Bank of New York.

\$ 418.15
\$ 2,424.85
\$41,466.51
\$ 886.00
100.00
8.84
\$41,466.51
\$ 886.00
\$ 2,424.85
\$41,466.51

1731

PERIOD ENDING 12. 1943 TO MAY 1. 1944

1944	JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER	TOTAL
MR. M. J. CURRY, ASST. TREASURER													
Remittance - S. O. Bates, Treas., San Francisco to M. J. Curry, Asst. Treas. New York - Amount of Remittance	\$0,330.00												\$ 0,330.00
Amount by M. J. Curry from Bank of Manhattan, of Unclaimed Bankers Check paid for in 1916 by Western Pacific Railway Co.	1-14-44	2-18-44	3-30-44	4-19-44	5-29-44	6-13-44	7-24-44	8-12-44	9-14-44	10-20-44	11-30-44	12-10-44	60,800.00
4,000.00	4,900.00	4,800.00	4,990.00	8,000.00	4,600.00	4,000.00	4,000.00	4,600.00	3,800.00	4,000.00	4,600.00	4,000.00	
Total Due to M. J. Curry - 1944													109.00
													\$32,897.70
THE MONTHLY STATEMENTS OF M. J. CURRY - ASST. TREASURER													
EXPENSES BY M. J. CURRY - OFFICE DISBURSMENTS													
W. F. Schaeffer - Salary	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	1,850.00	\$18,000.00
- Expenses	180.00	800.00	187.00	814.00	-	352.00	352.00	-	87.00	813.00	-	863.00	5,187.00
W. J. Curry - Salary	975.00	975.00	975.00	975.00	975.00	975.00	975.00	975.00	975.00	975.00	975.00	975.00	11,700.00
W. F. Campbell - Salary	855.00	855.00	855.00	855.00	855.00	855.00	855.00	855.00	855.00	855.00	855.00	855.00	10,260.00
W. F. Talbot - Salary	820.00	820.00	776.18	828.38	828.38	828.38	828.38	828.38	828.38	828.38	828.38	828.38	9,860.40
- Expenses	53.50	46.85	35.55	52.00	78.00	105.00	54.00	-	75.00	97.00	-	63.10	856.10
William O'Neill - Salary	230.00	230.00	411.07	237.38	237.38	237.38	237.38	237.38	237.38	237.38	237.38	237.38	2,827.87
Osborne Sheehan - Salary	170.00	170.00	320.32	188.38	188.38	188.38	188.38	188.38	188.38	188.38	188.38	188.38	2,404.68
Edmund Buchanan Pub. Co. - Salary	155.00	155.00	344.32	183.38	183.38	183.38	183.38	183.38	183.38	183.38	183.38	183.38	2,344.68
- By Age	-	-	-	-	-	-	-	-	-	-	-	-	-
Western Union Tel. Co. - Messages	7.08	5.41	-	8.46	4.00	-	6.78	6.70	-	7.14	-	6.88	48.86
Western Union Tel. Co. - Calendar	8.63	-	-	-	-	-	-	-	-	-	-	-	8.63
Western Union Tel. Co. - Rent	42.00	-	-	45.00	-	-	42.00	-	-	42.00	-	-	169.00
Crystal Springs Water Co. - Water	6.41	5.78	5.78	5.78	7.08	5.11	5.77	5.78	7.07	5.78	5.10	5.10	70.44
Peapack Trawl Supply Co. - Towels	8.30	8.30	8.30	8.30	8.30	8.30	8.30	8.30	8.30	8.30	8.30	8.30	100.00
Peapack Trawl Supply Co. - Tax Service	8.10	8.10	8.10	8.10	8.10	8.10	8.10	8.10	8.10	8.10	8.10	8.10	98.00
Commerce Clearing House - Consol. Stamp Mfg. Co.	80.00	-	-	-	-	-	-	-	-	-	-	-	80.00
Consol. Stamp Mfg. Co. - Stationery	6.08	-	7.87	-	-	-	-	-	-	-	-	-	13.95
Union Smith Bros. - Stationery	6.15	-	8.40	8.58	3.89	4.94	-	3.08	-	1.40	-	3.42	33.99
American Bank Note Co. - Number Bds.	30.41	9.16	45.08	3.08	10.97	-	1.00	7.12	1.00	4.08	-	-	100.00
Standard & Poor Corp. - Service	42.40	-	45.45	-	-	45.45	-	65.45	-	-	-	-	159.90
New York Telephone Co. - Service	61.35	59.79	135.30	125.04	76.89	61.97	65.98	50.38	66.11	55.68	63.19	60.32	881.80
Chase Nat'l. Bank of New York - Office Rent	37.84	47.87	47.87	47.87	405.87	405.87	405.87	405.87	405.87	405.87	405.87	405.87	4,782.04
- Electric Service	38.09	38.09	33.26	40.80	41.94	38.08	39.61	39.80	38.98	38.90	32.19	36.77	447.63
Central Banker Bank & Trust Co. - Services Paying Interest	-	98.61	-	-	-	-	98.69	-	-	-	-	-	197.30
- Gratuation Coupons	-	-	-	-	-	-	-	-	-	-	-	-	-
W. H. Brewer Co. - Stationery	-	12.32	-	24.67	19.51	22.74	6.84	6.42	18.08	1.78	5.16	4.66	112.33
W. H. Brewer Co. - Official Guide	-	3.78	-	-	3.78	-	-	-	-	-	3.78	-	15.00
W. H. Brewer Co. - Stationery	-	9.73	-	-	6.00	-	4.78	-	28.00	28.00	28.00	28.00	100.00
Albert Goldman, Pub. - Stamps	-	25.00	60.00	25.00	60.00	60.00	-	-	28.00	28.00	28.00	28.00	390.00
Stewart, Hansen & Will - Pld. Bond - M. J. Curry	-	-	12.00	-	-	-	-	-	-	-	-	-	12.00
Addressograph Divn. - Equip. Repair	-	-	8.22	-	-	-	-	-	-	-	-	-	8.22
Edmund Sheehan - Carbons	-	-	5.03	-	-	-	-	-	-	-	-	-	5.03
Langston Co. - Negatives	-	-	91.81	-	-	-	-	-	-	-	-	-	91.81
Hand Weekly Co. - Atlas & Guide	-	-	39.00	-	-	-	-	-	-	-	-	-	39.00
United Service Print. Corp. - Staty.	-	-	8.56	19.19	7.58	4.56	-	-	12.12	-	4.65	-	53.68
Langston Co. - Equip. Repairs	-	-	-	-	-	-	-	-	-	-	-	-	5.08
Edmund Sheehan - Ribbons	-	-	-	11.11	-	-	-	-	-	-	-	-	11.11
Langston Co. - Plates	-	-	-	3.44	-	-	-	-	-	-	-	-	3.44
Langston Co. - Stationery	-	-	-	-	14.39	-	-	-	-	-	-	-	14.39
Langston Co. - Photostats	-	-	-	-	-	7.42	41.01	13.28	2.73	-	-	-	64.44
Langston Co. - Cabinet	-	-	-	-	-	8.08	-	-	-	-	-	-	8.08
Langston Co. - Amer. Letters	-	-	-	-	-	-	25.00	-	-	-	-	-	25.00
Langston Co. - Industrials	-	-	-	-	-	-	36.38	-	-	-	36.36	-	72.74
Langston Co. - Back Copy	-	-	-	-	-	-	-	35.00	-	-	-	-	35.00
Langston Co. - Occupancy Tax	-	-	-	-	-	-	-	-	9.50	-	-	-	9.50
Langston Co. - Subscription	-	-	-	-	-	-	-	-	6.00	-	-	-	6.00
Langston Co. - Business Car Supplies	-	-	-	-	-	-	-	245.84	-	-	-	-	245.84
Langston Co. - Nations Bus.	-	-	-	-	-	-	-	-	9.80	-	-	-	9.80
Langston Co. - Pocket List NR Officials	-	-	-	-	-	-	-	-	3.00	-	-	-	3.00
Langston Co. - Ribbon	-	-	-	-	-	-	-	-	1.68	-	-	-	1.68
Langston Co. - Subscription	-	-	-	-	-	-	-	-	3.75	-	-	-	3.75
Langston Co. - Subscriptions	-	-	-	-	-	-	-	-	-	75.00	-	-	75.00
Langston Co. - Statistical Abt.	-	-	-	-	-	-	-	-	-	1.75	-	-	1.75
Langston Co. - Noterial Fee	-	-	-	-	-	-	-	-	-	6.25	-	-	6.25
Langston Co. - Railway Express agency	-	-	-	-	-	-	-	-	-	3.46	-	-	3.46
TOTALS	\$4,631.41	\$4,697.14	\$4,322.13	\$4,562.41	\$4,427.18	\$4,650.71	\$4,682.84	\$4,650.53	\$4,480.99	\$5,006.88	\$4,300.89	\$4,685.00	\$66,921.88

Less: Taxes included above, withheld and paid by W.F. RR. Co. S.F.
 Federal Income Tax
 Gross disbursed by M. J. Curry -
 Less: Payable of Office Rent paid by W.F. RR. Co. @ \$75.00 per Mo.
 Net Disbursed by M. J. Curry, 1944

Balance at December 31, 1944

Remittances, except May 1944, made by check drawn on W.F. RR. Co. Funds in Bank of California, San Francisco, in favor of M. J. Curry, Asst. Treas., and transmitted by U. S. Mail to M. J. Curry for deposit to credit of W.F. RR. Co. with Chase Nat'l. Bank of New York.

May 1944 Remittance made by check drawn on Funds of W.F. RR. Co. in American Trust Co. of San Francisco, and telegraphed by them direct to Chase Nat'l. Bank of New York for deposit to credit of W.F. RR. Co.

THE PACIFIC RAILROAD COMPANY

STATEMENT SHOWING FUNDS SUPPLIED BY THE PACIFIC RAILROAD COMPANY TO MR. M. J. CURRY, ASSISTANT TREASURER,
FOR THE MAINTENANCE OF THE NEW YORK OFFICE AND A DETAIL OF EXPENDITURES MADE FROM SUCH FUNDS IN NEW YORK.

PERIOD MARCH 15, 1942 TO MAY 1, 1942

<u>YEAR 1942</u>	<u>JANUARY</u>	<u>FEBRUARY</u>	<u>MARCH</u>	<u>APRIL</u>	<u>MAY</u>	<u>TOTALS</u>
					(A)	
<u>PER M. J. CURRY, ASST. TREAS. STATEMENT OF FUNDS RECEIVED</u>						
Sal. on hand Jan. 1, 1942	\$1,753.01	-	-	-	-	\$ 1,753.01
(B) Remittances - E. C. Bates, Treas., San Francisco, to M. J. Curry, Asst. Treas. New York	1-22-42	2-21-42	3-12-42	4-12-42	-	-
Date Remitted	4,000.00	3,800.00	3,800.00	3,800.00	-	14,800.00
Amount of Remittance	-	-	-	-	-	14,800.00
Total Rec'd. by M. J. Curry, 1942						\$16,553.01
<u>PER DETAIL FROM MONTHLY STATEMENTS OF M. J. CURRY, ASST. TREAS. COVERING N. Y. OFFICE EXPENDITURES</u>						
T. W. Schenck	- Salary	1,280.00	1,280.00	1,280.00	-	\$ 5,000.00
	- Expenses	97.00	-	347.00	-	584.00
M. J. Curry	- Salary	975.00	975.00	975.00	-	3,800.00
J. F. Weinken	- Salary	227.88	227.88	227.88	-	1,031.84
Mary C. Jalovich	- Salary	232.38	232.38	232.38	-	937.14
	- Expenses	-	96.00	21.00	-	90.00
Lillian O'Neill	- Salary	183.38	183.38	183.38	-	730.14
Catherine Knecht	- Salary	183.38	183.38	183.38	-	730.14
Chase National Bank	- Office Rmt	405.07	405.07	405.07	405.07	\$2,025.36
	- Electricity	38.23	40.08	39.51	44.44	158.26
Traffic World	- Subscription	3.78	-	-	-	3.78
Goldsmith Bros.	- Stationery	4.88	9.74	-	9.80	34.42
E. K. Brewer & Co.	- Stationery	7.43	2.43	3.19	-	13.05
Hygienic Phone Service	- Services	2.10	2.10	2.10	2.10	10.40
Crystal Spgs. Water Co.	- Water	5.78	2.10	5.78	10.07	33.73
Seaside Trawl Supply Co.	- Towels	17.60	9.30	9.30	-	80.80
Western Union Telegraph Co.	- Services	4.09	-	4.09	6.94	19.12
New York Telephone Co.	- Services	52.78	25.78	75.00	74.00	\$45.18
Albert Goldman P.M.	- Postage	25.00	25.00	25.00	-	100.00
Standard & Poore Corp.	- Services	45.45	-	-	15.15	80.60
Flomax Warehouse	- Warehouse	48.00	-	-	42.00	90.00
Commerce Clearing House	- Tax Service	80.80	-	-	-	80.80
United States Frig. Corp.	- Stationery	-	4.55	4.55	-	9.10
Webster-Barley Co.	- Stationery	-	3.78	-	-	3.78
Nat'l. Ry. Pub. Co.	- Official Guide	-	3.78	-	3.78	7.56
A.R. Marcus Co.	- Men's Wm	-	10.00	-	-	10.00
The Signature Co.	- Services	-	200.00	-	-	200.00
Central Bankers Bk. & Trust Co.	- Services Paying Interest	-	56.99	-	-	86.88
Flomax Warehouse	- Carriage	-	-	-	10.30	10.30
Langton Co., Inc.	- Photostats	-	112.14	-	-	112.14
Wall Street Journal	- Subscription	-	-	-	5.00	5.00
Addressing Mach. & Equip. Co.	- Ribbon	-	1.00	-	-	1.00
Stewart-McNicken & Will	- Fid. Bond-M. J. Curry	-	12.50	-	-	12.50
Bank W. Wall & Co.	- Guide	-	-	39.90	-	39.90
Langton Co., Inc.	- Stationery	-	-	2.43	.75	3.18
TOTALS		\$2,242.20	\$2,222.20	\$2,121.20	\$2,42.20	\$15,022.20

Less Taxes included in above, withheld and paid by

W.F. RR. Co. San Francisco:

Railroad Retirement Tax

Federal Income Tax

Gross disbursed by M. J. Curry

Less Progn. of office rental paid by

CHAS. RR. \$ 975.00 per month

Less Collections from Individuals for

personal telephone tolls

Net disbursed by M. J. Curry, 1942

M. J. Curry - Asst. Treas. Sal. at 5-31-42

Rec'd. by Treas. E. C. Bates - San Francisco,

from Asst. Treas. M. J. Curry, New York, June 1942

NOTE

(A) Expenditures shown above for May 1942, cover expense of maintaining New York Office for purpose of paying bills incurred prior thereto and closing Office.

(B) Remittances made by check, drawn on W.F. RR. Co. funds in Bank of California, San Francisco, in favor of M. J. Curry, Asst. Treas. and transmitted by D. S. Hall to M. J. Curry for deposit to credit of W.F. RR. with Chase Nat'l. Bank of City of New York.

EXHIBIT 214
4/16/42 CO

THE WESTERN PACIFIC RAILROAD COMPANYSTATEMENT SHOWING ALL PAYMENTS MADE BY THE WESTERN PACIFIC RAILROAD COMPANY TO EITHER MR. T. M. SCHUMACHER,
MR. M. J. CURRY, OR MISS MARY VALLOUGH IN ADDITION TO THOSE PAYMENTS INCLUDED IN STATEMENT NO. 1PERIOD MARCH 16, 1943 TO MARCH 31, 1948

		JANUARY	FEBRUARY	MARCH	APRIL	MAY	JUNE	JULY	AUGUST	SEPTEMBER	OCTOBER	NOVEMBER	DECEMBER	TOTAL
<u>Year 1945</u>														
T. M. Schumacher	- Pension					\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$ 8,000.00
M. J. Curry	- Pension					247.74	81.34	89.54	89.54	89.54	89.54	89.54	89.54	884.32
Mary C. Vallough	- Severance Pay				\$1,239.78	-	-	-	-	-	-	-	-	1,239.78
TOTAL - 1945						\$1,239.78	\$1,081.34	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$10,078.07
<u>Year 1946</u>														
T. M. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$12,000.00
M. J. Curry	- Pension	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	1,074.68
TOTAL - 1946		\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$13,074.68
<u>Year 1947</u>														
T. M. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$1,000.00	\$12,000.00
M. J. Curry	- Pension	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	89.54	1,074.68
TOTAL - 1947		\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$1,089.54	\$13,074.68
<u>Year 1948</u>														
T. M. Schumacher	- Pension	\$1,000.00	\$1,000.00	\$ -										\$ 2,000.00
M. J. Curry	- Pension	89.54	89.54	89.54										268.62
TOTAL TO MARCH 31, 1948		\$1,089.54	\$1,089.54	\$ 89.54										\$ 2,268.62
TOTAL ADDITIONAL AND SUBSEQUENT PAYMENTS														<u>\$28,442.96</u>

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THE WESTERN PACIFIC RAILROAD COMPANY

LIST OF CORPORATE OFFICERS AND TERMS THEREOF, JANUARY 1, 1915 TO FEBRUARY 12, 1968

	Year 1955	Year 1956	Year 1957	Year 1958	Year 1959	Year 1960	Year 1961	Year 1962	Year 1963	Year 1964	Year 1965	Year 1966	Year 1967	Year 1968 to Date
President	Charles Kiley	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Chairman of the Board	A. C. James	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Chairman of the Exec. Comm.	T.W. Schumacher	Same	Same	Same	Same	Same	Same	Same	Same	T.W. Schumacher to 12/28/44	(No Chairman of Executive Committee elected)			
Vice Pres. & General Mgr.	E. W. Mason	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	E. W. Mason to 6/30/46 H.A. Mitchell from 7/2/46	H.A. Mitchell	Same
Vice President-Traffic	J. P. Hogan	Same	Same	J. P. Hogan to 8/29/58 Vacant from 8/29/58	Vacant	Vacant	Vacant to 12/1/61 H.M. Foulter from 12/1/61	H.M. Foulter	Same	Same	Same	Same	Same	Same
Vice President, Asst. Sec'y. & Asst. Treasurer	H. J. Curry	Same	Same	Same	Same	Same	Same	Same	Same	Same	H. J. Curry to 4/30/45 No successor elected.	--	--	--
Vice President	--	--	--	--	--	--	--	--	--	--	--	E. W. Mason from 7/2/46 to 12/31/46	--	--
Vice President	--	--	--	--	--	--	--	--	--	--	--	W. Holt from 3/26/45 T.P. Forrester from 3/28/45	Same	Same
Vice President	--	--	--	--	--	--	--	--	--	--	--	Same	Same	Same
Secretary	W. G. Brown	Same	W. G. Brown to 8/9/57 C.L. Drait from 8/9/57	C. L. Drait	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Assistant Secretary	C. L. Drait	Same	C.L. Drait to 8/9/57 Logan Palms from 8/9/57	Logan Palms	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Assistant Secretary	--	--	--	--	--	--	--	--	--	Mary Valouch from 12/4/44	Mary Valouch to 4/30/45	--	--	--
Assistant Secretary	--	--	--	--	--	--	--	--	--	--	--	L. E. Lepp from 3/28/45	Same	Same
Assistant Secretary	--	--	--	--	--	--	--	--	--	--	--	H.B. Thiering from 3/28/45	Same	Same
Treasurer	H. C. Bates	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same
Assistant Treasurer	--	--	--	--	--	--	--	--	H.B. Larson from 12/6/43	Same	Same	Same	Same	Same
General Auditor	D.C. DeGraff	Same	Same	Same	Same	Same	Same	Same	Same	Same	Same	D.C. DeGraff to 6/27/46 C.F. Russell from 6/27/46	C.F. Russell	Same
Assistant to President	--	--	--	--	--	--	--	H.B. Larson from 1/2/46	Same	Same	Same	Same	Same	Same

Office of Secretary,
San Francisco, Calif.,
February 12, 1968.

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PLAINTIFF'S EXHIBIT No. 28

Memorandum for File

Supplementing information on the Memorandum of Conference dated June 2, 1943, relating to assumption of certain salaries and expenses of the New York office by the Trustees, the following details are for record:

	Previ- ously paid by Trustees	Previ- ously paid by W.P. Corp.	Total now to be paid by Trustees	Annual Total
M. J. Curry.....	\$ 600.00	\$375.00	\$ 975.00	\$11,700.00
H. Brua Campbell	416.66	208.33	625.00	7,500.00
Mary C. Valouch	191.66	28.33	220.00	2,640.00
John F. Wienken	156.25	83.33	239.58 +	2,875.00
Lillian O'Neill	148.33	21.66	170.00	2,040.00
Catharine C. Sheehan	145.00	20.00	165.00	1,980.00
Total Salary Roll	<u>\$1,657.90</u>	<u>\$736.65</u>	<u>\$2,394.58</u>	<u>\$28,735.00</u>

(Monthly accounts adjusted end of year to annual totals)

Miscellaneous Expenses

Rent offices	188.34	188.34	376.68 (Month to month)
Electric (approx.)....	18.00	18.00	36.00
Storage (approx.) ....	.....	14.00	14.00
Phone (approx.) ....As req'd		25.00	?
Postage (approx.) ..As req'd		18.00	?
Total former W.P. Corp. proportion		<u>1,009.00</u>	

San Francisco
June 2, 1943
(E.W.E.)

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 29

New York, January 27, 1943.

Mr. Curry:

My secretary, Mary C. Valouch, who has been doing my work since Walter Mittelberg left, has, as you know, assumed additional duties, particularly of a research and statistical character and handles our tax matters.

She is doing this work in a satisfactory manner so I am increasing her salary, effective January 1, 1943, on The Western Pacific Railroad Company payroll to \$2,300 per year, which is an increase of \$300 a year over her present salary—my former secretary received \$3,400 a year from the Company.

Please arrange your payroll accordingly.

T. M. SCHUMACHER

(Original signed by) T. M. Schumacher.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 30

Memorandum of Conference

June 2, 1943.

At a conference held today between Messrs. Schumacher, Ehrman, Matthew and Elsey, it was agreed that the following changes should be made with respect to employes and expenses of the New York office:

1. Effective as of June 1, 1943, all employes of the New York office heretofore acting as joint employes of the Reorganization Trustees and The Western Pacific Railroad Corporation will be taken over as full time employes of the Trustees, viz:

M. J. Curry

H. Brua Campbell

Mary C. Valouch

John F. Wienken

Lillian O'Neill

Catherine C. Sheehan

2. The Trustes will assume the full rental of the New York office, together with all expenses for miscellaneous supplies and services incident to maintenance of the quarters.

3. It was understood that the above changes will increase the Trustees' expenses by approximately \$1,000 per month. Mr. Curry will continue to report to the General Auditor, as heretofore, details as to salaries and expenses but on the single employer basis now agreed upon.

4. It was agreed that the Trustees would not pay any part of the Corporation's franchise tax (\$1691.75 to April 1944).

5. Although the employes above mentioned will be receiving more compensation from the Trustees than formerly, it is the opinion of Mr. Dooling that no authority will be required from the Salary Stabilization Unit of the Bureau of Internal Revenue with respect to Mr. Curry or from the War Labor Board, with respect to other employes, since none of them will be receiving more compensation from a single employer than they formerly received as joint employes.

6. It was understood that Mr. Schumacher would make necessary application to the Reconstruction Finance Corporation to cover Mr. Curry's increased salary on the Trustees' payroll, such consent from the R.F.C. being necessary in accord with terms of the Trustees' loan agreement with R.F.C.

CHARLES ELSEY.

Copy to Mr. T. M. Schumacher
Mr. Sidney M. Ehrman
Mr. Allan P. Matthew
Mr. D. C. DeGraff
Mr. E. C. Bates

San Francisco, California,
June 7, 1943.
(EWE)

1740 *Western Pacific R.R. Corp., et al., vs.*

The Western Pacific Railroad Company

37 Wall Street,

New York.

June 18, 1943.

Mr. Charles B. Henderson, Chairman,
Reconstruction Finance Corporation,
Washington, D. C.

Dear Mr. Henderson:

Pursuant to Subdivision (a), Item 3, of Agreement dated November 23, 1938, between the undersigned Trustees in Reorganization of The Western Pacific Railroad Company, Debtor, and the Reconstruction Finance Corporation, and supplements thereto, filed on December 2, 1940 and December 1, 1941, this is to respectfully request the written consent of the Reconstruction Finance Corporation to the following changes in salaries, effective June 1, 1943:

Mr. M. J. Curry, Vice President, Assistant Secretary and Assistant Treasurer, in our 37 Wall Street, New York Office, to be increased from \$600 to \$975 per month.

Mr. H. Brua Campbell, of Pierce & Greer, Counsel at New York, 40 Wall Street, to be increased from \$416.66 to \$625. per month.

These changes are brought about by reason of the fact that, effective as of June 1, 1943, all employees of the New York Office heretofore acting as joint employees of the Reorganization Trustees and The

Western Pacific Railroad Corporation (holding company) will be taken over as full time employees by the Trustees of the Debtor Company.

The total compensation paid Mr. Curry and Mr. Campbell are shown in Exhibit "C" attached to the aforementioned agreement. Mr. Curry's total salary (amended in accordance with your letter of March 25, 1943) remains unchanged. Mr. Campbell's total salary, however, is \$208.33 per month less than shown on Exhibit "C."

Your Corporation's consent to the aforementioned changes will be appreciated.

Yours very truly,

T. M. SCHUMACHER &
SIDNEY M. EHRMAN,
Trustees in Reorganization,

THE WESTERN PACIFIC
RAILROAD COMPANY,

By /s/ T. M. SCHUMACHER,
One of the Trustees.

cc. Messrs. Ehrman, Elsey, Matthew & Nicodemus.

[Endorsed]: Filed Feb. 2, 1949.

1742 *Western Pacific R.R. Corp., et al., vs.*

PLAINTIFF'S EXHIBIT No. 31

November 9, 1943

Col. Robert E. Coulson
40 Wall Street
New York 5, N. Y.

Re: Western Pacific Reorganization

Dear Col. Coulson:

This will acknowledge receipt of your firm's letter of November 8, 1943, enclosing the report of the Reorganization Committee of the selection of officers and counsel and the designation of mailing address and adoption of by-laws.

This also seems very formal and excessively regular but nevertheless I wish to write informally to congratulate the Reorganization Committee on the selection of your firm as its counsel. As counsel for the Debtor as well as for the Western Pacific Railroad Corporation I stand ready to cooperate to the fullest extent in expediting the reorganization.

At the risk of possible repetition of what I have said to you personally I think your firm will render a distinct service if it insists on the preparation of trust indentures of a somewhat different character than those that have been used in recent reorganizations.

Yours very truly,

F. C. NICODEMUS, JR.

cc:

Mr. T. M. Schumacher.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 32A

April 21, 1945

Mr. Charles Elsey, President
The Western Pacific Railroad Company
526 Mission Street
San Francisco, California

Dear Mr. Elsey:

Since Mr. Droit left I have spent some time discussing with Mr. Schumacher and Mr. Curry some of the problems incident to the closing of the office of The Western Pacific Railroad Company at 37 Wall Street. In this connection I have made certain suggestions, some of which are not a matter of concern to your company but one of which at least is understood to be subject to your approval.

As to Miss Vauloch and Miss O'Neill who have been in the office at 37 Wall Street, I have agreed to employ them in this office quite independently of any tax work being done for your company. They will, of course, lose their Railroad Retirement protection since they leave the employ of a carrier but for that they are compensated by the six months' severance allowance, which I understand your company to have provided. In our opinion the fact that they promptly take employment in this office will have no bearing on the six months' retirement allowance you are giving them.

Mrs. Sheehan, who has been in the office at 37 Wall Street, is not desirous of taking other employ-

ment at the moment and seems quite satisfied with her six months' severance provision.

As to Mr. Wienken, there seems to be no other course than for him, with the protection of his six months' severance pay, to secure other employment. We are not able to make any place for him in this organization or to justify any arrangement to secure his availability in connection with pending tax problems of your company.

As to Mr. Curry, my suggestion has been that this office retain his services for the present on an annual basis to make investigations and furnish us with reports and to be available as a witness in connection with the pending tax questions which your company has up with the Federal Government. As president of the old holding company, which is a party in interest (without financial stake) in the consolidated return period, it seems to us essential that we have Mr. Curry available to secure us necessary data from the files of the holding company. On the other hand, it is not feasible for the holding company to maintain a New York office on its own account because of certain tax problems which arise under New York State laws. Under the arrangement which I have proposed, we would make available to Mr. Curry an office in which he could go over tax data in connection with studies and reports we desire and furnish him with stenographic assistance in compiling his reports. He would not, in any sense, be an "employee" of this office. It is our opinion that such

work as an independent contractor would not constitute "entering the service" of the operating company so as to prevent payments to him under the Provisional Retirement Plan of your company even though we expected, as we would, to be reimbursed by your company for the annual retainer paid him as an expense of the tax proceeding. The same applies, we think, to the Railroad Retirement benefits which Mr. Curry will receive, although we have made no extended study on this point. Mr. Curry, however, will have to resign his position as a nominal vice president of the Denver and Rio Grande for the purpose of stock transfers, in which connection he has been receiving compensation. Otherwise his Railroad Retirement benefits would not accrue.

The amount I suggest by way of annual retainer to Mr. Curry from this firm is \$3,000. There is no doubt in my mind that his usefulness in connection with the tax matters will justify such a payment to him for the next year or two. Taken together with his Railroad Retirement payments and his Provisional Retirement Plan payment, this proposed retainer will also serve to tide him over a period which would otherwise be somewhat difficult for him.

Everyone seems to be in the mood to be quite content and happy if a program, such as is outlined above, can be worked out. This does not mean that Mr. Schumacher views with pleasure not having an office available and he still expresses some

concern as to whether the Western Pacific is wise to be without a New York office other than traffic offices. Also, I received a rather vehement protest from Mr. Nicodemus, whose solution was to have the holding company, in conjunction with the Denver and Rio Grande, continue to maintain the office at 37 Wall Street on a substantially reduced scale. There are, however, obstacles to any such program which seem to me to be insuperable.

Please let me have, as promptly as you can, your reaction to that part of the program outlined above in which the operating company has a definite interest, viz., the proposed retainer to Mr. Curry to be paid by us and reimbursed to us as one of our disbursements in connection with the pending tax matters.

Sincerely yours,

/s/ ROBERT E. COULSON.

[Stamped]: The Western Pacific R.R. Co.,
President, Apr. 24, 1945.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 39e

April 8, 1943

Col. Robert E. Coulson
40 Wall Street
New York, N. Y.

Dear Col. Coulson:

Referring to my recommendation to Messrs. Schumacher and Ehrman that your firm be en-

gaged as advisory counsel to aid Mr. Matthew and me in the solution of the serious problems that will arise in connection with the preparation of final Federal tax returns for the calendar year 1942, I am just in receipt of advice from Mr. Schumacher that this recommendation in which Mr. Matthew has concurred is agreeable to the two Trustees and that they desire me to arrange forthwith for your firm's services.

Since you already have advised me informally of your firm's willingness to undertake this work I write merely to confirm the arrangement and to say that I will hold myself in readiness to confer with your Mr. Polk and to make available to him such data as has been supplied to me and such further data as he may desire.

The firm of Lybrand, Ross and Montgomery has been employed in connection with certain accounting problem and I understand their services will be available to us to the extent that we deem necessary.

Yours very truly,

/s/ F. C. NICODEMUS, JR.

[Endorsed: Filed Feb. 2, 1949.]

PLAINTIFF'S EXHIBIT No. 39F

April 20, 1943

F. C. Nicodemus, Jr., Esq.
40 Wall Street
New York, N. Y.

Western Pacific

Dear Mr. Nicodemus:

This is a belated acknowledgement of your letter of April 8, 1943. I had assumed from its text and from the fact that Mr. Polk and you were already at work when I received your letter that you needed no formal acknowledgment. However, it may be better, as a matter of record, that you should have a formal acknowledgment of the fact that we have undertaken the Federal tax work for the Trustees as advisory counsel in conjunction with yourself and Mr. Matthews.

Sincerely yours,

/s/ ROBERT E. COULSON.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 42

The Western Pacific Railroad Company

November 15, 1948

To Whitman, Ransom, Coulson & Goetz, Dr., Attorneys and Counsellors at Law, 40 Wall Street, New York.

Final statement covering professional services in connection with Federal tax disputes as to the taxable period from January 1, 1942, through April 30, 1944	\$300,000.00
Retainer payments, July 1, 1945, to December 31, 1948, to M. J. Curry.....	10,500.00
	<hr/>
Total	\$310,500.00

Received Payment,

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

December 19, 1947

Mr. Charles Elsey, President
The Western Pacific Railroad Company
526 Mission Street
San Francisco, California

Dear Mr. Elsey:

In connection with the tax work which I and my associates have been carrying on for The Western

Pacific Railroad Company during the 1947 calendar year I have had prepared a statement which is enclosed. This statement covers such services on a time basis and does not purport to include any fee for the substantial tax savings effected for the period from 1942 through the first four months of 1944. You will, I think, concur in my view that any statement covering the fee for this special tax matter should not be determined or submitted until any possibility that the settlement agreement might be reopened by the Treasury Department is foreclosed by the expiration of the statutory period of limitations as to all the taxable years involved, and possibly even until there is at least a preliminary determination in the pending litigation in which The Western Pacific Railroad Corporation is seeking to assert an interest in such tax savings.

When you have reviewed the enclosed statement for current services, and the disbursements in connection therewith, please call me up if there is any question in your mind about them. From the standpoint of The Western Pacific Railroad Company it might be better to have any payment made on account of these services made during the current calendar year.

Sincerely yours,

/s/ JAMES K. POLK.

[Stamped]: The Western Pacific Railroad Co.,
President, Dec. 22, 1947.

Whitman, Ransome, Coulson & Goetz
40 Wall Street, New York

November 15, 1948

Mr. Charles Elsey, President
The Western Pacific Railroad Company
526 Mission Street
San Francisco, California

Dear Mr. Elsey:

On December 19, 1947, I wrote you as to the time when a bill should be rendered covering the services of myself and my associates in connection with the special Federal tax matter which resulted in substantial tax savings for the period from January 1, 1942 to May 1, 1944. It was suggested in my letter that no statement should be submitted for this special tax matter until the settlement agreement was protected from any suggestion on the part of the Treasury Department that the matter be reopened prior to the expiration of the statutory period of limitations as to all the taxable years involved. The statutory period of limitations as to the years involved ended on June 30th of this year and so far as that element is concerned there is no reason why a final statement should not be rendered.

My letter of December 19, 1947 also raised for consideration the possibility that a final bill might be deferred until there had been at least a preliminary determination in connection with the litigation in which the Western Pacific Railroad Corporation is seeking to assert an interest in the bene-

fits derived by The Western Pacific Railroad Company from the final disposition with the Treasury Department of the issues for the taxable period mentioned. We have given consideration to this aspect of the matter and have reached the conclusion that the balance of advantage to your company would be to have a final bill rendered during the calendar year 1948. You will no doubt wish to discuss this aspect of the matter with Mr. Matthew, as counsel for your company in the pending litigation between The Western Pacific Railroad Corporation and your company.

In order to put this matter in concrete form, I am enclosing a statement covering such services. The amount shown by this statement seems to us to represent a fair and reasonable basis of charge. In addition the statement shows the retainer payments which have been made and are being made through this office until the end of the current year to Mr. Curry in order that he might be available for research and as a witness in the event the matter had gone to trial instead of being settled.

If there is any aspect of this matter as to which you wish further information, do not hesitate to call me up here in the office.

Sincerely yours,

/s/ JAMES K. POLK.

[Stamped]: The Western Pacific Railroad Co.,
President, Nov. 19, 1948.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 43

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

July 25, 1944

M. J. Curry, Esq., President,
The Western Pacific Railroad Corporation,
37 Wall Street,
New York 5, N. Y.

Dear Mr. Curry:

We have given the matter of adoption of declared value on the 1944 Capital Stock Tax Return for The Western Pacific Railroad Corporation consideration after discussing with Miss Valouch and Mr. Reilly the present estimates of declared value excess profits tax net income for the calendar year 1944.

You realize that the tax statute does not attempt to require a measurement of real or actual value of the capital stock and that the problem involved in the adoption of a declared value is one of selecting an amount which will incur a minimum combined capital stock tax and declared value excess profits tax liability. The adoption of a declared value of at least ten times the estimated taxable income for the year 1944 is necessary to escape the declared value excess profits tax provisions of the Act and a reasonable margin of protection must be added to provide for possible increases in taxable income over any present estimate.

The best judgment of the Company officials and

employees would seem to be that there will be no declared value excess profits tax net income derived by the Corporation for the calendar year 1944. Accordingly, it is believed that the capital stock tax return may properly reflect a declared valuation of zero for the Western Pacific Railroad Corporation.

We have also reviewed the draft of the capital stock tax return and accompanying statement of Trustees which has been prepared for The Western Pacific Railroad Company. Since it is believed that the Corporation will not have title to the property during the calendar year 1944 and the ownership will continue in the Trustees in Reorganization, the return and accompanying statement of Trustees reflects no capital stock tax liability for The Western Pacific Railroad Company.

Review has also been had of the copies of capital stock tax returns proposed to be filed for the Sacramento Northern Railway, the Tidewater Standard Railway Company, The Western Realty Company, the Standard Realty and Development Company and the Delta Finance Company, Ltd. As previously stated, the basis of the declaration of value should be at least ten times the estimated declared value excess profits tax net income of each corporation. Under the method of computing the declared value excess profits tax liability this income is substantial statutory revenue less statutory deductions, the net result of which is reduced by 85% of the dividends received from domestic corporations and by 10% of the valuation declared on the capital stock

tax return. It is assumed that the respective corporate officials have based their declarations of value on estimates of income for these Companies for the year 1944 so as to eliminate through the 10% credit on the declared value any declared value excess profits tax net income. We have no means of reviewing with the Company officials the estimates of income which formed the bases for the adopted values set forth in the capital stock tax returns.

The copies of the returns which were submitted with your letter of July 19th are herewith returned to you. It is requested that at your convenience copies of these papers be furnished us for our files. It is assumed that you will wire Mr. DeGraff so that the returns may be timely filed by him.

Very truly yours,

WHITMAN, RANSOM, COUL-
SON & GOETZ.

July 26, 1944

Via air mail: Special Delivery.

Mr. D. C. DeGraff, General Auditor,
The Western Pacific Railroad Company,
526 Mission Street,
San Francisco 5, Calif.

Dear Mr. DeGraff:

After receiving copies of the 1944 Returns of Capital Stock Tax, which were enclosed with your letter of July 21st, they were delivered to our Tax

Counsel, Mr. James K. Polk of Whitman, Ransom, Coulson & Goetz, for his review, having previously submitted to him for consideration the question of the parent company's Capital Stock Tax Return.

I am in receipt of a reply from his firm, copy of which I am enclosing for your information.

I am also enclosing 1944 Return of Capital Stock Tax for The Western Pacific Railroad Company and Statement of Trustees, both executed by Mr. T. M. Schumacher, as Trustee. We would appreciate it if you will send us conformed copies of all returns filed for our records.

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. James K. Polk:

Mr. F. C. Nicodemus, Jr.

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 50

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

May 20, 1943

Mr. M. J. Curry,
Vice President,
Western Pacific Railroad Company,
37 Wall Street,
New York, N. Y.

Dear Mr. Curry:

On May 15, there were filed at the Office of the Collector of Internal Revenue, Custom House, New York, the Federal income, excess profits tax and declared value excess profits tax returns for the Western Pacific Railroad Company and its affiliated corporations. The items entering into the preparation of these returns were reviewed by us and on the basis of the information available, it is believed that the returns as filed met all of the conditions of the Internal Revenue Code and Bureau regulations in respect of the substantive matter contained therein and of supporting schedules.

It is believed, however, that a considerable amount of supporting detail and underlying data must be prepared in order that the figures set forth in the return can be supported upon subsequent Bureau audit. While it is true that much of this underlying detail will relate to the earnings and profits determination which, in turn, will probably

Plaintiff's Exhibit No. 50—(Continued)

have little effect upon invested capital, it is believed, however, desirable that the research be carried through in order that the position we assert in the returns may be hedged against the adverse implications of possible distributions out of capital which may have occurred up to the date of the last dividend payment in 1927. Further, we have used in the returns, book costs as bases for the affiliated corporations' stock investments which again may require adjustments, possible of determination only after such analyses.

It is also believed desirable to have a more complete review made of the computation of the unused excess profits credit adjustment. In the return as filed, it was assumed that the invested capital base for the years 1940 and 1941 was substantially the same as for the taxable year 1942. Undoubtedly, changes will be indicated when the schedules for borrowed invested capital and inadmissible adjustments for 1940 and 1941 have been prepared in detail. This adjustment will, in all probability, have no effect upon the 1942 tax return but will afford a more proper basis for administrative consideration of tax matters for 1943 and subsequent years.

It is further noted that a historical development of the profit and loss accounts of the several companies, not only as disclosed in their books, but as set forth in the reconciliations reported in prior Federal income tax returns, will bring to light any

Plaintiff's Exhibit No. 50—(Continued)

instances of write-ups, write-downs, etc. The survey of this character will also serve to establish more definite amounts of net operating loss deductions and carryovers.

Both in connection with the review of the deductions claimed for depreciation and the amounts shown for fixed capital investment returns, it will be helpful to review the significant tax positions adopted by the company and accepted by the Bureau of Internal Revenue in connection with the audits by the Bureau of Internal Revenue of prior year income tax returns. While not estopped by prior considerations and decisions, the Bureau may be disinclined to depart from previous determinations of basis of fixed capital investments as shown by treatment in computing depreciation deductions and in computing gains and losses upon the disposition of assets.

It may also be noted that it is clearly demonstrable that the consolidated return basis of reporting for the year 1942 as contrasted with a separate basis of reporting, was advantageous to the group. Since consolidated returns were filed for 1940 and 1941, any unused excess profits credit inhered in the common parent corporation, had separate returns been filed for 1942. A preliminary survey of the smaller affiliates indicates that they would have incurred no excess profits tax liability. The operating company, however, if placed on a separate basis without the benefit of the credit carry-

Plaintiff's Exhibit No. 50—(Continued)

overs, would have been liable for a net excess profits tax liability of \$3,650,000 even if all other figures as shown in the return were left unchanged. This amount is offset by several factors. In the first place, on an individual basis, the operating companies' interest on expense deductions would have increased \$703,000. It would have lost, however, its allocable share of the net operating loss reduction of approximately \$438,000. Further, a portion of its earnings subject to excess profits tax rates would have been eliminated from normal tax rates. There would have been, in addition, a reduction in the surtax rate on a separate basis of the 2% penalty for filing a consolidated return, which would have amounted to approximately \$200,000 in tax. All of these factors combine to establish a net tax advantage of in excess of \$1,550,000 in the adoption of the consolidated return under the separate return.

There is a further possibility of adjustment under the Internal Revenue Code provisions contained in Sections 23(g)(4) and (k)(5) by which the worthlessness of the operating company's stock may produce a net loss for the year 1943 with possible carryback application. This is commented upon rather than suggested as of certain value, since it is paradoxical to compute a loss upon the operating company's stock which, through the mechanics of consolidated return reporting, could be used to nullify the very income of the affiliate whose

Plaintiff's Exhibit No. 50—(Continued)

stock had become worthless. This matter will receive more careful consideration when the completion of the reorganization makes possible the assertion of the claim for worthlessness of the operating company's stock.

Apart from the 1942 tax liability, we are informed that a request has been addressed to the company for the submission of basic data to be considered by the Bureau of Internal Revenue in connection with the application made under date of March 29, 1943, for permission to change the method of accounting from retirement to a depreciation basis for Federal income tax purposes. Under general procedures adopted in the Bureau the premission to change the basis of accounting is premised upon the agreement of the applicant to adoption of accumulated depreciation reserve balances which, at the election of the company, may be determined by any one of the following methods:

1. The accounts may be reconstructed from their beginning, or may start with the I.C.C. valuation, setting up as a reserve the difference between cost of reproduction new and cost of reproduction less accrued depreciation as determined at the valuation date. From either starting point, the capital accounts shall be carried forward, increased by additions and decreased by retirements, except that any increase in replacement costs, or additions or betterments expensed, which have been deducted for

Plaintiff's Exhibit No. 50—(Continued)

income tax purposes, may not be restored. Depreciation at rates to be agreed upon shall be computed for all years and accrued into a depreciation reserve. From this reserve shall be deducted the cost of normal retirements, but for retirements due to casualty or special obsolescence, which would have been allowable under depreciation accounting, only the accrued depreciation thereon shall be deducted.

2. A reserve may be set up by multiplying the expired life of individual structures, or the weighted average ages of the accounts representing groups of assets, now in service, by the depreciation rates agreed upon for these assets.

3. A reserve of 30% of the total depreciable accounts at the date of change may be set up. It is to be understood that this is on overall reserve and the total amount so computed is to be allocated to the different depreciable accounts on a reasonable basis, such allocation to be a matter of agreement between each railroad and the Bureau.

We are familiar with the requirements of the Bureau of Internal Revenue in connection with depreciation computations generally embodied in the Valuation Division questionnaire, the provisions of T.D. 4422 and related Bureau rulings, and have discussed the railroad situation with the Bureau of Internal Revenue officials to whom these matters are assigned. It will, undoubtedly, be necessary

Plaintiff's Exhibit No. 50—(Continued)

to complete preliminary computations under the elective methods prescribed, and to compare the possible annual benefits of depreciated accounting with the retirement basis heretofore followed, before administrative action can be taken to complete the application for permission to change accounting basis filed with the Bureau of Internal Revenue.

We will be glad to confer with your company officials in planning these preliminary surveys so, if possible, to minimize the work required and will be glad to make available to you the benefit of our experience in the assembly and presentation of data to the Bureau of Internal Revenue, if you elect to take advantage of the depreciation basis of tax accounting for 1943.

Very truly yours,

/s/ JAMES K. POLK.

[Stamped]: The Western Pacific Railroad Corp., Received May 21, 1943.

[Stamped]: T. M. S. May 21, 1943.

[Endorsed]: Filed Feb. 2, 1949.

123
File
U R G E N T

June 26, 1943

eat. Louder;
MEMO FOR ~~FILE~~

Western Pacific

Will it embarrass you in the Western Pacific situation if the corporate charter of the Western Pacific Corporation is cancelled by the State of Delaware for failure to pay its 1940 Delaware franchise tax prior to July 1, 1943?

REC

Until the Revised provisions we are urging for incorporation into the Internal Revenue Code are adopted it is essential to protect the possible use of the net loss carryover that the holding company continues until the consummation of its reorganization. It would require more study of the causal. Retin regular before all the advantages of continuation of chartered before 6/30 can be voted.

8/15/43

40 WALL STREET

NEW YORK

1001 FIFTEENTH STREET,
WASHINGTON, D.C.

LE ADDRESS
HEROINE

May 26, 1943

EXH. 91A
r/h/48 L.G.

Mr. James K. Polk
40 Wall Street
New York, N. Y.

Dear Mr. Polk:

Attached is form of communication to security holders which The Western Pacific Railroad Corporation would like to hand out to persons applying at its office for information as to the status of the Corporation.

Is there any reason in your mind, in connection with your letter to the Railroad Company of May 20, 1943, why the Corporation should not do this?

Yours very truly,

F. C. Nicodemus, Jr.

R DIST. CT N D CAL.

26508-5

52

ED. FLB 2 1949

R. Elington

Washington. The President's plan is to give a
reply to the proposal of the British Government
in the case that it contains the same
which is to be put into the hands of the
man who is to be put into the hands of the
President.

31A

The Western Pacific Railroad Corporation

37 Wall Street
New York, N. Y.

To Holders of The Western Pacific Railroad Corporation Preferred Stock and Common Stock:

As information, we give you below a brief statement as to the status of this Corporation.

This Corporation is a holding company and not an operating railroad company. Its investments comprise the common and preferred stocks of The Western Pacific Railroad Company, one-half of the common stock of The Denver & Rio Grande Western Railroad Company and, in addition, certain other securities of both companies. These operating companies have been in process of reorganization since late in 1935, and, as a result, the Corporation has received no income on these investments during that period.

Aside from the preferred and common stocks of The Western Pacific Railroad Company, the balance of the securities owned by this Corporation are pledged as collateral under loans which have been in default since 1934 and on which interest has accumulated.

After lengthy court procedure, throughout which this Corporation was represented by Counsel to protect the interests of its stockholders, the Western Pacific case was appealed to the United States Supreme Court for review. On March 15, 1943,

that court rendered its decision, affirming the plan of reorganization which was promulgated by the Interstate Commerce Commission and approved by the Federal District Court in San Francisco. That plan declares the unsecured indebtedness and the preferred and common stocks of The Western Pacific Railroad Company to be without value.

The bank serving as Registrar of the Corporation's preferred and common stocks, having given notice of its resignation, effective May 1, 1943, and in view of the poor financial condition of the Corporation, it was determined by the officers that as Corporation no certificates for preferred stock or preliminary to liquidation and dissolution of the common stock would be accepted for transfer after April 29, 1943. The New York Stock Exchange suspended trading in the preferred stock on April 29, 1943 (the common stock had been delisted in 1939, since which time it has been traded in the Over-the-counter market).

In view of the Supreme Court's decision, which indicates clearly that the unsecured indebtedness and the preferred and common stocks of The Western Pacific Company (all owned by this Corporation) are of no value and, further, that all other securities owned by the Corporation are pledged as collateral under loans in default, and as the Corporation is without funds to continue its corporate existence, we regret to state we do not believe that during the course of liquidation and dissolution any assets will remain for distribution to holders

of the Corporation's preferred and common stocks.

JOHN F. WIENKEN,
Secretary.

date?

[Endorsed]: Filed Feb. 2, 1949.

PLAINTIFF'S EXHIBIT No. 53

January 8, 1944

Memorandum

In Re: Western Pacific Reorganization Trustees
1943 Federal Income Tax Return

Conferences were held today with Mr. Elsey, Mr. Englebright, Mr. DeGraff, and Mr. Gloster at the Company offices, and with Mr. Elsey and Mr. Matthew at luncheon in connection with the deduction to be claimed by the parent company on loss on the operating company's stock, their effect thereof upon the tax liability of the subsidiary operating company.

It was explained that under Internal Revenue Code provisions losses on the stock of operating subsidiary companies were specifically removed from the capital gains and loss classification and accordingly allowed as operating losses and, on consolidated return treatment the parent company loss could offset subsidiary company incomes.

The Western Pacific Railroad Corporation's investment in the (operating) Western Pacific Railroad Company's stock has been shown at \$75,000,000.

The basis is under any calculation well in excess of the operating income of the operating company for 1943.

There has been accrued on the operating company's books through November a reserve for Federal tax liability of approximately \$7,500,000. Since there will be no tax liability if this operating loss deduction on the consolidated return basis is allowed the suggestion was made that the books of account be adjusted so as to reflect at December 31 no accrual for Federal tax liability on the part of the operating company for 1943.

After considerable discussion it was decided tentatively to set up a "Reserve for Road Improvement" in an amount approximating the \$7,500,000 figure. This action is to be taken upon order of the court after appropriate application for same. As a preliminary step the procedure is to be further studied and submitted to the Reorganization Committee for their approval, which if obtained is to be then submitted to the Trustees for their approval. In support of the dollar reserve, accrual engineering studies are to be compiled showing cost of change of existing rails from 80 to 112 pounds, installation of continuous block system, substitution of concrete for timber tunnel linings, and possibly extension of centralized traffic control. Studies are also to be included of cost of acquiring modernized passenger and freight equipment. Further conferences are to be held Monday on these matters.

Mr. Gloster furnished the undersigned with a

preliminary draft of engineering studies on machinery and equipment investments for consideration in connection with the Bureau requirements for submission of data under Treasury Mimeograph 58.

Discussions were also had with Mr. Matthew and Mr. Elsey concerning the program for corporate readjustment and substitute lease arrangements with the Salt Lake City Union Depot and Railroad Company. Mr. Matthew has completed a draft of lease and a copy is to be furnished me for review. In the draft Mr. Matthew has made provision for limited preferred stock dividend requirements, but in the light of the discussion of Mr. McAllister's suggestions has noted that these provisions are subject to revision to accord with the proposals prepared by Mr. Hart and the undersigned. Mr. Matthew is to join in the conferences to be held Monday in regard to both the tax return and the Salt Lake Depot matters. A request was made that opinion letter of counsel be drafted covering the tax return deduction item and this will be done after review of the applicable statutory provisions Monday.

J. K. P.

[Endorsed]: Filed Feb. 2, 1949.

1772 *Western Pacific R.R. Corp., et al., vs.*

PLAINTIFF'S EXHIBIT No. 58

Filed Feb. 21, 1944

C. W. Calbreath, Clerk

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California

In the District Court of the United States, for the
Northern District of California, Southern Division

No. 26591-S

7100 000

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

PETITION FOR AUTHORITY TO ESTABLISH A RESERVE FUND FOR CONTIN-
GENT TAX LIABILITIES

T. M. Schumacher and Sidney M. Ehrman, the
duly appointed, qualified and acting Trustees of the
properties of the Debtor above named, hereinafter
referred to as the Trustees, hereby represent to the
Court and petition as follows:

I.

The Trustees are advised and believe that the
Debtor and the Trustees have no Federal income
or excess profits tax liability for the year 1943.
However, the Commissioner of Internal Revenue

has not yet passed upon the question, and the Trustees believe that it is in the best interests of the estate of the Debtor to provide a reserve fund out of which 1943 Federal income and excess profits taxes may be paid in the event that liability therefor should be established. The Trustees are advised and believe that the sum of \$7,100,000 will be adequate to cover any possible liability for such taxes for the year 1943. The estate of the Debtor contains sufficient cash derived from the earnings of the railroad of the Debtor during the year 1943 to establish a reserve fund in the amount of \$7,100,000 without using funds required for other purposes.

II.

It is the judgment of the Trustees that such reserve fund should be invested in United States Treasury securities. The Trustees propose to designate the fund as the "Reserve Fund for Contingent Tax Liabilities."

Wherefore, your petitioners pray that they be authorized to establish, out of the earnings of the railroad of the Debtor during the year 1943, a reserve fund in the amount of \$7,100,000, to be designated as the "Reserve Fund for Contingent Tax Liabilities," to be invested in United States Treasury securities, and to be used for the payment of any Federal income and excess profits taxes which may be found due for the year 1943.

ALLAN P. MATTHEW,
Counsel for Petitioners.

State of California,
City and County of San Francisco—ss.

Charles Elsey, being first duly sworn, deposes and says:

That for more than twelve years last past he has been the President of The Western Pacific Railroad Company and since the appointment of the Trustees of the properties of said Company he has been their Agent in immediate charge of the railroad and other property of that Company; that he has read the foregoing petition and knows the contents thereof and the same is true of his own knowledge.

CHARLES ELSEY.

Subscribed and sworn to before me this day
of February, 1944.

[Notarial Seal]

.....,
Notary Public in and for the City and County of
San Francisco, State of California.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 63

January 23, 1945

Memorandum for Colonel Coulson:

The Western Pacific Railroad Company Journal
Entries Reflecting Completion of Reorganiza-
tion

A conference was held today by Colonel Coulson,
L. J. Gosney and the undersigned in which were

Plaintiff's Exhibit No. 63—(Continued)

discussed the principles involved in the suggested journal entries attached to and made a part of the memorandum of conference of January 17, 1945, with the Bureau of Accounts of the Interstate Commerce Commission.

It was noted that the fundamental premise of such journal entries was that there must be reflected upon the books of the continuing corporate entity the factual changes occasioned by the reorganization, and that this premise necessarily rejects any such concept as the Bureau of Accounts apparently had when they suggested in their letter of December 6, 1944, opening up a new set of books for a new corporation.

It was clearly understood and agreed that under no circumstances would the corporation jeopardize its primary tax advantage deliberately secured through the maintenance of the continuity of the 1916 corporation by voluntarily filing any proposed journal entries of the type suggested in the letter of December 6, 1944. Subject to such amendments, additions and corrections of dollar figures as will develop from the use of the December 31, 1944, closing figures, it is the position of counsel and of Colonel Coulson as a member of the Board, that the entries as reflected in principle in the memorandum of the January 17th conference should form the basis of the proposed journal entries to be prepared and submitted for Interstate Commerce Commission consideration.

Plaintiff's Exhibit No. 63—(Continued)

There is attached a photostatic copy of a work sheet reflecting the type of balance sheet before and after journal entries of the kind indicated in the January 17th memorandum. It was noted, of course, that the position estimated as of December 31st will probably vary materially in the cash and current asset classifications from the actual figures which will form the starting point for the proposed journal entries and schedules to be submitted to the Interstate Commerce Commission. It will also be noted that the resulting balance sheet will reflect an unearned surplus of approximately \$83,000,000.00 and that of this sum only the amount of \$75,800,000.00 is to be classified as "paid-in surplus" for Federal income tax purposes, the balance constituting "accumulated earnings and profits" in any invested capital or source of dividend distribution computation.

A discussion was also had with regard to the book accounting in respect of the interest on the income bonds. The payment of interest on these securities cannot be determined until sometimes between January and May when the formal action of the Board of Directors in its determination of available income and authorization of the payment of interest is the ultimate act bringing into existence liability on the part of the corporation for payment. Thus from a technical viewpoint the interest is accruable only when and as there is this formal Board action. From a practical viewpoint, there is

Plaintiff's Exhibit No. 63—(Continued)

equal justification for this position since the corporation enjoys the use of the borrowed funds whether or not during each year there are available earnings to pay interest, and the use of the borrowed funds justifies a deduction of compensation equally in every year. The payment within a calendar year is a fair compensation for the actual use of borrowed money during that calendar year.

There is a further tax aspect which is of extreme importance and that is that theoretically and practically there could be no accrual of interest at any time prior to the issuance of the bonds and to insist that there were such an accrual would be an attempt to secure a small interest deduction for 1944 in comparison to the interest deduction now allowable on the old debt structure up to the turnover date under the St. Paul decision. As far as is concerned the practical booking of interest on the income bonds in 1945, subject to some objection which we cannot find in the Interstate Commerce Commission's prescribed system of accounts, it might be that there could be accrued monthly one-twelfth of an estimated annual interest payment on the bonds by a debit to interest expense and a credit to a reserve for estimated interest liability. Upon the payment of interest, for instance in May of 1945, cash could be credited and this reserve debited and the reserve balance immediately after such entry constituting a deferred charge to the remaining months in the year would be absorbed by the monthly entries of the

Plaintiff's Exhibit No. 63—(Continued)

remaining months in the year. In this manner there would be no distortion as between months of income statements. As to the handling of this, however, in the current accounts—so long as there is no reflection of liability at December 31, 1944, for any accrued interest on the income bonds—this office would be glad to receive the comments and suggestions of the accounting officers of the corporation.

Colonel Coulson suggested that as soon as the December 31st figures are available every effort should be made to have a preliminary draft of the journal entries prepared and forwarded to this office for review as to tax implications as well as for Interstate Commerce Commission presentation purposes. It was his suggestion that a memorandum of this conference and of the January 17th conference together with the exhibits be forwarded to Mr. DeGraff so as to give Mr. DeGraff the viewpoint of this office on these matters.

J. K. P.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 64

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

May 31, 1946

Mr. C. R. Krigbaum
Internal Revenue Agent in Charge
225 Broadway
New York, N. Y.

Attention: Mr. T. K. Leahy

The Western Pacific Railroad Corporation
Federal Income Taxes 1942 and 1943

Dear Sir:

The audits of the Federal Income Tax Returns filed by the above named corporation are now being made by representatives of your office. In advance of the consideration of other issues, preliminary review is being given to the deduction claimed in the 1943 tax return for the loss sustained in the worthlessness occurring during that year in the stock of The Western Pacific Railroad Company. In order to facilitate the consideration of this matter, and without any attempt at this time to submit arguments in support of the claim of the taxpayer, there is furnished below a summary of the facts believed pertinent in this matter. The taxpayer specifically reserves the right to supplement this statement of facts and to submit a brief in support of the propriety of the claim for deduction in 1943.

The Western Pacific Railroad Corporation was

Plaintiff's Exhibit No. 64—(Continued)

organized under the laws of the State of Delaware in 1916 and has owned at all times from on or about July 14, 1916, to April 30, 1944, all of the outstanding stock of The Western Pacific Railroad Company. This latter company is a California corporation which has owned and operated railroad properties in the States of California, Nevada and Utah from 1916 to date. On August 2, 1935, a petition was filed in the United States District Court for the Northern District of California, Southern Division, for reorganization of The Western Pacific Railroad Company under the provisions of Section 77 of the Bankruptcy Act, as amended; simultaneously, a copy of said petition was filed with the Interstate Commerce Commission.

During 1936, 1937 and 1938 various plans of reorganization were filed with the Interstate Commerce Commission and hearings were held by the Commission. The resulting plan of reorganization formulated by the Interstate Commerce Commission was duly certified to the United States District Southern Division, and that Court after further hearings and argument, on August 15, 1940, entered an order approving the plan of reorganization proposed by the Interstate Commerce Commission.

All plans of reorganization filed with the Interstate Commerce Commission by the parties recognized value for the stock of The Western Pacific Railroad Company. The exclusion of the stock

Plaintiff's Exhibit No. 64—(Continued)

from participation by the Interstate Commerce Commission in the plan which it promulgated was vigorously contested before the Commission and before the United States District Court, both by the debtor company and by other parties to the proceeding.

Appeals were duly taken from the aforesaid order of the United States District Court to the United States Circuit Court of Appeals, Ninth Circuit, and in a decision handed down November 28, 1941, the Circuit Court of Appeals reversed the order of the District Court and ordered the case remanded for further proceedings. A principal contention of the debtor company, The Western Pacific Railroad Corporation, and other appellants before the Circuit Court of Appeals, was that the asset value and earning power of the debtor justified the participation of its stock in the reorganization. The Circuit Court of Appeals sustained this contention to the extent of holding that the Commission and the District Court had made no findings to justify the exclusion of this stock from participation. The Commission plan was based upon a forecast of earnings in the light of the worst depression experience the railroads had ever had. It is submitted that it is obvious that at the time of the Circuit Court of Appeals' decision the financial condition of the debtor was such that it would have been impossible to make any current findings of fact which would exclude the stock from participation in the reor-

Plaintiff's Exhibit No. 64—(Continued)

ganization. Accordingly, the Circuit Court of Appeals' reversal of the District Court was a practical insurance of participation in the reorganization by the equity ownership of the debtor company.

Petitions for certiorari to review the Circuit Court of Appeals decision were filed in the United States Supreme Court early in 1942. These petitions for review were granted by the Supreme Court on April 27, 1942, and the matter was argued before that Court in October, 1942. In the proceeding before the Supreme Court, the debtor and The Western Pacific Railroad Corporation both vigorously presented the claim that the decision of the Circuit Court of Appeals be sustained and that the demonstrated earning power and fair value of the operating properties warranted recognition of value for the stock. On March 15, 1943, the United States Supreme Court reversed the Circuit Court of Appeals and sustained the United States District Court, remanding the case to that Court for further proceedings under the provisions of Section 77 of the Bankruptcy Act. A petition for rehearing in this matter was denied by the Supreme Court and its decision became final on or about April 19, 1943.

Thereafter during the year 1943 the proceedings which are expressly required by the provisions of Section 77 of the Bankruptcy Act, as preliminary to a confirmation of a plan of reorganization, were taken in this case. The votes of security holders on acceptance of the plan were canvassed

Plaintiff's Exhibit No. 64—(Continued)

and recorded by the Interstate Commerce Commission. The favorable result of the vote was duly certified by the Interstate Commerce Commission to the United States District Court as required by the Bankruptcy Act. Thereafter upon notice to all parties and publication, a hearing was had on the confirmation by the United States District Court. On the record made at such hearing, the District Court under date of October 11, 1943, entered its order of confirmation of the plan. No appeals were taken from said order and it became final on or before November 20, 1943.

Under the plan of reorganization so confirmed by the United States District Court, The Western Pacific Railroad Corporation was excluded from any participation, and its stock ownership in The Western Pacific Railroad Company thereupon became worthless. The taxpayer claims that the stock of The Western Pacific Railroad Company at all times, until the date of the Supreme Court decision March 15, 1943, had a real and material fair market value, and that the stock became worthless on or after March 15, 1943, and, accordingly, that the loss occasioned by the worthlessness of the stock was properly deductible under the provisions of Section 23 (g) of the Internal Revenue Code in the determination of the consolidated taxable net income for 1943.

Very truly yours,

WHITMAN, RANSOM,
COULSON & GOETZ.

PLAINTIFF'S EXHIBIT No. 65

Know All Men By These Presents, that The Western Pacific Railroad Corporation, a Delaware corporation, by these presents hereby makes, constitutes and appoints James K. Polk and Harold F. Noneman, of the law firm of Whitman, Ransom, Coulson & Goetz, 40 Wall Street, New York 5, New York, and Patrick J. Cavanaugh, an attorney associated with said firm, or either of them, its true and lawful attorneys, to appear for it and represent it before the Treasury Department, in connection with any matter involving its Federal Income Tax for the taxable years 1940 to 1945 inclusive, and to appear for and represent it before the Bureau of Internal Revenue, or any unit, division, or agent or employee thereof relative to any tax liability claimed against it for the taxable years 1940 to 1945 inclusive, giving and granting its said attorneys full power to do everything whatsoever requisite and necessary to be done in the premises, and to receive refund checks, to execute waivers of the statute of limitations, and to execute closing agreements, as fully as the undersigned might do if personally present, with full power of substitution and revocation, at any time subsequent to the date hereof and prior to the revocation hereof.

It is hereby requested that a copy of all communications regarding any matter in which the said attorneys are hereby authorized to act be addressed to James K. Polk, Esquire, at his office address, 40 Wall Street, New York 5, New York.

All powers of attorney heretofore given for the purposes herein enumerated by the undersigned are hereby revoked.

In Witness Whereof, the said The Western Pacific Railroad Corporation has caused its corporate name to be signed hereto by its President and its corporate seal affixed and attested by its Secretary all as of the 26th day of June, 1946.

THE WESTERN PACIFIC
RAILROAD CORPORATION,

[Seal] By /s/ M. J. CURRY,
President.

Attest:

/s/ M. C. VALOUCH,
Secretary.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 66

[Western Union Telegram Form]

CDU771 NL PD-CD New York NY 6

Allan P. Matthew,
Balfour Bldg., S Fran.

Received Dec. 7, 1946.

Answered 12/7/46 BE

We have an embarrassing situation in connection with examinations before trial in pending stockholders' suits because of various capacities in which

Curry has acted. He is president of the holding company. As such he holds certain files and papers of the holding company. We have pointed out necessity of distinction between these files and files of correspondence written or received by him or Schumacher as former officers of operating company. These files belong to operating company and should be technically in our custody as tax counsel insofar as they involve the tax matters. Curry raises question under your letter May 8, 1945 to bankruptcy trustees. Schumacher asked Curry to act as his representative in retaining custody of trustees books and records. This has been construed to include all correspondence with officers of operating company during reorganization period. In our judgment records directly affecting operating company must necessarily be turned over to operating company by bankruptcy trustees even though they remain available to bankruptcy trustees. Can you clear this situation by wire to us or directly to Mr. Curry?

COULSON.

[Marginal note]: W. P. REORG.

[Stamped]: Received Dec. 7, 1946.

[Stamped]: Ans'd. Dec. 7, 1946.—BE

[Endorsed]: Filed Feb. 3, 1946.

PLAINTIFF'S EXHIBIT No. 68

The Western Pacific Railroad Corporation
100 West Tenth Street,
Wilmington 99, Delaware.

At New York 5, N. Y.
40 Wall Street,
(Fifty-first Floor)

April 4, 1947.

Pierce & Greer,
44 Wall Street,
New York 5, N. Y.

Attention: Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Herewith copy of letter dated April 2, 1947, and enclosure, from Mr. James K. Polk, of Whitman, Ransom, Coulson & Goetz, in regard to the Corporation's Federal Income Taxes for years 1942 and 1943 and period January 1 to April 30, 1944. A copy is also being sent to Mr. A. Perry Osborn.

This will be presented to the Board at meeting called for next Tuesday, the 8th, for consideration and such action as the Board may direct.

Yours very truly,

/s/ M. J. CURRY,
President.

Enclosure

cc. Mr. A. Perry Osborn,
20 Exchange Place,
New York 5, N. Y.

Plaintiff's Exhibit No. 68—(Continued)
(Copy)

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York.

April 2, 1947.

Mr. Michael J. Curry,
President,
The Western Pacific Railroad Corporation,
Room 5205,
40 Wall Street,
New York, N. Y.

Federal Income Taxes for Years 1942 and
1943 and Period January 1 to April 30, 1944.

Dear Mr. Curry:

As you doubtless know, Internal Revenue Agent Thomas Leahy has been conducting an examination of the operations of The Western Pacific Railroad Corporation and its affiliated companies for the calendar years 1942 and 1943 and the period from January 1 to April 30, 1944. His activities in this connection seem to be approaching completion. I have thoroughly covered with him all phases of the matter and this report is being made to you so that you may be advised of its current status.

In the course of his examination, Revenue Agent Leahy originally determined, on a tentative basis, that the worthlessness of the stock of The Western Pacific Railroad Company occurred in the year 1940. Although in view of the intermediate status of the matter no formal advice or notice of a proposed deficiency had been or could then be received, our ten-

Plaintiff's Exhibit No. 68—(Continued)

tative computations indicated that the deficiencies that would be asserted on the basis of any such determination as to the year of loss, would be considerably in excess of any reserve provision heretofore made against such tax liability. We immediately took the matter up with the local office of the Internal Revenue Agent in Charge, and various conferences were held at which were presented the taxpayer's views that this loss occurred in the year 1943.

The matter was submitted by the Internal Revenue Agent in Charge to the Office of the Commissioner of Internal Revenue in Washington, D. C. for advice. Conferences were held with Bureau officials in Washington in connection therewith. It was first proposed by the Bureau officials at Washington to support the tentative determination of the field examiner that the stock became worthless in 1940. In further conferences in Washington it was suggested that the matter was one appropriate for disposition by settlement or agreement between the parties. At the request of the Commissioner's Office, a written proposal as a basis for settlement was made by me as attorney-in-fact under date of February 11, 1947, a copy of which I am enclosing. After consideration by the Bureau officials, the case was recently returned by them to the local office of the Internal Revenue Agent in Charge. Revenue Agent Leahy, whose investigation was to a large extent suspended during the pendency of the matter in Washington, has now resumed his activities and is, we believe, now in the process of completing the draft of his report. His

Plaintiff's Exhibit No. 68— (Continued)

conclusions, we are hopeful, are now in accord with the proposal submitted to the Washington officials.

The proposal as to a possible basis for settlement is presently pending in the local office of the Internal Revenue Agent in Charge and will continue in that status until final action thereon can be taken by the appropriate Bureau officials. Under the Bureau practice and the necessities of this particularly difficult case, there will probably be an interval of at least two months before an agreement can be reached with those who must approve it, if it is accepted. It can be revoked at any time prior to such acceptance and there will be ample time for consideration by you and your associates before definitive action is taken.

If the Government approves the proposed basis for settlement, it will be an unusually advantageous disposition of the matter. The doubts as to the construction of the applicable Internal Revenue Code provisions are so real and the factual background so involved, that the Government would certainly be fully justified in resisting our claim in its entirety, if complete recovery were to be sought for 1942 as well as avoidance of all liability for 1943 and the period ended April 30, 1944. We would then be compelled to pursue our rights even to the Supreme Court of the United States. In any such extended litigation, we would necessarily incur all of the risks usually attendant upon any litigation, plus the inevitable bringing to bear on the problem, in behalf

Plaintiff's Exhibit No. 68—(Continued)

of the Government, of a succession of fresh and ingenious minds, eager to establish full tax liability in a case involving such large sums. The determination of the year of worthlessness is a factual matter involving a risk of loss which in itself, in my carefully considered opinion, fully justifies the proposed basis of settlement. This is entirely apart from other serious defenses which would most certainly be asserted by the Government, if it were to contest our position in the case.

It is, therefore, my definite recommendation that in the event the Government advises us of its willingness to close the matter on the basis suggested in the attached proposal, that the matter be so disposed of as promptly as possible. You will, of course, be advised promptly of any definitive corporate action required from your corporation to that end. I cannot impress upon you too much the depth of my conviction as to the importance of moving promptly when and if opportunity arises to close this matter on the basis proposed. I am fortified in this by the years of my experience in the Bureau of Internal Revenue and my knowledge of the extreme sensitivity which attends the situation in the Bureau in any case of this magnitude.

I will be glad to discuss this matter with you and your associates at any convenient time.

Very truly yours,

/s/ JAMES K. POLK.

1792 *Western Pacific R.R. Corp., et al., vs.*

Plaintiff's Exhibit No. 68— (Continued)
(Copy)

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

February 11, 1947.

The Honorable Joseph D. Nunan, Jr.,
Commissioner of Internal Revenue,
Washington, D. C.

Attention: Mr. Frank Eddingfield.

Re: The Western Pacific Railroad Corpo-
ration and Affiliated Corporations
1942, 1943 and 1944 Federal Income
Taxes.

Dear Sir:

The Western Pacific Railroad Corporation and its affiliated subsidiaries filed consolidated returns for the calendar years 1942 and 1943 and the said Western Pacific Railroad Corporation filed a consolidated return for the calendar year 1944 including therein its said subsidiaries for the period from January 1, 1944, to April 30, 1944, during which period affiliation existed.

On the said return for 1942 a consolidated tax liability of \$4,201,821.54 was reported and duly assessed and paid. On the said return for 1943 there was reported a net loss and no taxable income. On the said return for 1944, based on a carryover of the unused 1943 net loss, there was reported no taxable income and no tax liability. A claim for refund of the tax so paid for 1942, based on a carryback of the said

Plaintiff's Exhibit No. 68—(Continued)

1943 net loss, was filed and is now pending in your office.

The taxpayer on behalf of itself and its aforesaid affiliated subsidiaries hereby offers to settle and determine the tax liabilities of the said corporations for the said taxable years 1942, 1943 and 1944 in the amounts shown on the returns filed as aforesaid. This proposal of settlement does not relate to or affect the tax liability of the said subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated. The within proposal is made without prejudice to any rights or claims of the parties, if the proposal is not accepted by you.

As part of this proposal The Western Pacific Railroad Corporation, on behalf of itself and its aforesaid affiliated subsidiaries agrees that, if this proposal is accepted, it will consent to a rejection of the said claim for refund of the 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is further agreed by the said The Western Pacific Railroad Corporation on behalf of itself and its aforesaid affiliated subsidiaries that if this proposal is accepted it will execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

Authority for the submission of the within propo-

Plaintiff's Exhibit No. 68—(Continued)
sal of settlement by the undersigned is contained in
a Power of Attorney heretofore filed in your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION

JAMES K. POLK,
Attorney-in-Fact.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 69

The Western Pacific Railroad Corporation
100 West Tenth Street,
Wilmington 99, Delaware.

May 5, 1947.

At: New York 5, N. Y.
40 Wall Street,
Fifty-first Floor.

Mr. James K. Polk,
Messrs. Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York 5, N. Y.

Dear Mr. Polk:

After the conference between the Board Committee dealing with Corporation tax matters, and yourself, held in your office on April 15th, we have further

considered the questions involved and the points raised at the conference.

We are prepared to recommend to the Board the sending to you of a letter of general approval of the proposed tax settlement, outlined in your letter to the Corporation under date of April 2nd, signed by myself as President, with a copy of an authorizing resolution of the Board.

We will expect to be informed as to the progress of the negotiations and if there are any changes in the proposed settlement the Corporation must be entirely free to reconsider its approval.

Although we wish to be entirely cooperative in this matter, the Corporation finds itself embarrassed by the action of the Western Pacific Railroad Company in opposing judicial settlement of the allocations of tax benefits, if any, derived from the application of the capital losses of the Corporation for the benefit of the Group. The Railroad Company's pleadings that the Railroad Corporation should be denied its day in court by reason of the statute of limitations and the District Court's injunctive order in reorganization, does not invite the kind of cooperation from the Railroad Corporation that a settlement of the tax case, so ably and fairly proposed by you as counsel for both the Railroad Company and the Railroad Corporation, requires. Had there been any question of the Railroad Corporation's right to a determination of the question of allocations of tax benefits, we feel sure that counsel representing both the Railroad Company and the Railroad Corporation would have

specifically stipulated, at the time of the filing of the consolidated returns, for such allocation to be determined by the court, if the parties found themselves unable to agree thereto. Inasmuch as in the proposed settlement the Railroad Corporation foregoes its refund claim of \$4,200,000, we think it appropriate that a stipulation promptly be entered into between the Railroad Company and the Railroad Corporation, and the other members of the Group, which will insure the Corporation its day in court for a settlement of the questions of proper and equitable allocations of tax savings, if any, as well as fixing the amount of the refund as the basis for such savings.

We trust you will use your good offices, representing both parties in this situation, to secure the approval of the Railroad Company to such a stipulation.

Very truly yours.

/s/ M. J. CURRY,
President.

cc: Mr. F. C. Nicodemus, Jr.
Mr. A. Perry Osborn
Mr. Willis D. Wood

[Endorsed]: Filed Feb. 3, 1949.

No. 12506

**United States
Court of Appeals**
for the Ninth Circuit.

**WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I.
duP. BAYARD, Receiver,**

Appellants,

vs.

**WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,**

Appellees.

**MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE
& CO., INC.,**

Appellants,

vs.

**WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN
REALTY COMPANY, THE STANDARD REALTY AND DE-
VELOPMENT COMPANY and DELTA FINANCE CO., LTD.,**

Appellees.

Transcript of Record
In Five Volumes

Volume V
(Pages 1797 to 2176)

**Appeals from the United States District Court,
Northern District of California,
Southern Division.**

JUL 24 1950



No. 12506

United States
Court of Appeals
for the Ninth Circuit.

WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I.
duP. BAYARD, Receiver,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

MEREDITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE
& CO., INC.,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRAMENTO
NORTHERN RAILWAY, TIDEWATER SOUTHERN RAILWAY,
DEEP CREEK RAILROAD COMPANY, THE WESTERN
REALTY COMPANY, THE STANDARD REALTY AND DE-
VELOPMENT COMPANY and DELTA FINANCE CO., LTD.,

Appellees.

Transcript of Record
In Five Volumes

Volume V
(Pages 1797 to 2176)

Appeals from the United States District Court,
Northern District of California,
Southern Division.

PLAINTIFF'S EXHIBIT No. 70

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

May 6, 1947.

Mr. M. J. Curry,
40 Wall Street,
Room 5205,
New York, N. Y.

Dear Mr. Curry:

This acknowledges your letter of May 5th as to the pending tax matters for the years 1942, 1943 and 1944, The Western Pacific group, in which I act as tax counsel. Obviously, as your letter suggests, the only thing that I could do in connection with a possible stipulation between the various interested companies in connection with pending litigation between them as to allocation, would be to "use my good offices". The use of my good offices would necessarily be limited to calling to the attention of the other members of the group the fact which I have impressed upon your group; namely, that there is a common interest in concluding promptly the proposed settlement which I have been negotiating with the Treasury Department. It would in my judgment be disastrous if controversies between the members of the group, which could properly await subsequent disposition, should make impossible a settlement along the lines heretofore outlined to your group.

As you know, the legal representation of the rail-

road company in this matter is entirely in the hands of Mr. Allan P. Matthew of the firm of McCutchen, Thomas, Matthew, Griffiths & Greene of San Francisco. I understand that Mr. Matthew is represented here in New York in connection with the New York proceedings by Mr. Crouch of the firm of Clark, Carr and Ellis. My function is definitely limited to the dealings with the Treasury Department in connection with the tax controversy where certainly all members of the group have a common interest. I have sent a copy of your letter to me and a copy of this letter to Mr. Allan P. Matthew.

Naturally, I am at the disposition of you and your associates and of any other member of the corporate group as to the method of computing the settlement or any other information which will be helpful in ironing out such differences as may exist between members of the corporate group. In closing, however, let me emphasize again the vital element that this controversy between the members of the corporate group shall not be allowed to interfere with an advantageous settlement with the Treasury Department, as to which there is clearly no conflict in interest.

Sincerely yours,

JAMES K. POLK.

Copies to: Mr. Nicodemus
 Mr. A. P. Osborn
 Mr. Willis D. Wood

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 71

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

May 19, 1947.

Mr. C. R. Krigbaum,
Internal Revenue Agent in Charge,
225 Broadway,
New York, N. Y.

The Western Pacific Railroad Corporation
and Affiliated Corporations

1942, 1943 and 1944 Federal Income Taxes.

Dear Sir:

Reference is made to the conference held in your office May 6th with regard to the tax liabilities of The Western Pacific Railroad Corporation and its affiliated companies for the taxable years 1942, 1943 and 1944.

At this conference an agreed basis of settlement of the tax liabilities involved was reached and this letter contains the written undertaking of the taxpayers effectuating the settlement.

The taxpayer on behalf of itself and its affiliated subsidiaries agrees to settle and determine the tax liabilities of said corporation for the taxable years 1942, 1943 and 1944 in the amounts shown on the returns as filed. This proposal of settlement accordingly relates to the consolidated returns filed for the calendar years 1942 and 1943 and 1944, in which said return for 1944 The Western Pacific Railroad Corporation included therein its subsidiaries for the

period January 1, 1944 to April 30, 1944, during which period affiliation existed. This settlement does not relate to or affect the tax liability of the subsidiaries from and after April 30, 1944 when their affiliated status with The Western Pacific Railroad Corporation was terminated.

As part of the settlement The Western Pacific Railroad Corporation consents to the rejection of the pending claim for refund of 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is also stipulated that The Western Pacific Railroad Corporation on behalf of itself and its affiliated subsidiaries will, if this settlement is accepted, execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

The settlement reached with your office is agreed to without prejudice, however, to any rights or claims of the parties in the event the settlement is not accepted by the Commissioner of Internal Revenue.

Authority for settlement of the tax liabilities of the above named taxpayers by the undersigned is contained in power of attorney heretofore filed with your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,

JAMES K. POLK,
Attorney-in-Fact.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 72

The Western Pacific Railroad Company
Western Pacific Building,
526 Mission Street,
San Francisco 5, California.

February 11, 1947.

Via Air Mail

073

James K. Polk, Esq.,
c/o Carlton Hotel,
Washington, D. C.

Dear Mr. Polk:

In order that you may have definite authorization from this Company to proceed in connection with the pending controversy as to Federal income taxes for the years 1942, 1943 and 1944, as to which you hold power of attorney, I have today conferred with all available directors. All of the directors I have been able to reach, constituting a majority of the directors, have concurred in the proposal that you submit in writing to the Commissioner of Internal Revenue a definite proposal that the three years 1942, 1943 and 1944 be settled on the basis of no refund and no additional tax.

We understand that the year 1944 is involved in this controversy, so far as this Company is concerned, only during the period of affiliation, that is, through April 30, 1944, and that for the balance of the year 1944 the taxes of this Company will be determined on the basis of its separate return for that period outside the affiliation.

This authorization will be formally ratified at a meeting of the Board of Directors to be held early in March, 1947.

Very truly yours,

/s/ CHARLES ELSEY.

Copy by regular mail.

Draft—2/25/4. .—JKP:EMD

The Western Pacific Railroad Company

March , 1947.

Resolution of Board of Directors

The President submitted to the Board a copy of a letter which was submitted by James K. Polk, Tax Counsel for the Company, to the Commissioner of Internal Revenue relative to the settlement of Federal Income Tax liabilities for the years 1942, 1943 and so far as this Company and its affiliates are concerned, the first four months of 1944. He stated that prior to the submission of that letter, the matter had been taken up with the members of the Board individually and the approval and authorization of a majority of the Board to the submission of that letter had been obtained. He stated that following such submission to the individual members of the Board, he had instructed Mr. Polk in writing to make such offer. A copy of the President's letter was presented to the meeting. After consideration and on motion duly made and seconded, it was

Resolved, that the submission of the afore-

said letters, copies of which were presented at this meeting, be and the same are in all respects ratified, affirmed and approved.

“The Chairman submitted to the Board a copy of a letter which was submitted by James K. Polk, Tax Counsel for the Company, to the Commissioner of Internal Revenue relative to the settlement of Federal Income Tax liabilities for the years 1942, 1943 and so far as this Company and its affiliates are concerned, the first four months of 1944. He stated that prior to the submission of that letter, the matter had been taken up with the members of the Board individually and the approval and authorization of a majority of the Board to the submission of that letter had been obtained. He stated that following such submission to the individual members of the Board, he had instructed Mr. Polk in writing to make such offer. A copy of the President’s letter was presented to the meeting. After consideration and on motion duly made and seconded, it was

Resolved, that the submission of the aforesaid letters, copies of which were presented at this meeting, be and the same are in all respects ratified, affirmed and approved.”

I, C. L. Droit, Secretary of The Western Pacific Railroad Company, a corporation, as such Secretary do hereby Certify that the foregoing is an Extract from the minutes of proceedings of a regular meeting of the Board of Directors of said corporation, duly and regularly convened and held at the office

of said corporation on the 4th day of March, 1947, at which a quorum of said Board was present; that the motion and resolution set forth in said Extract were duly adopted by said Board at said meeting and have not been rescinded or amended and remain in full force and effect.

In Witness Whereof, I have hereunto signed my name as such Secretary and affixed the seal of said corporation this 28th day of March, 1947.

[Seal] /s/ C. L. DROIT,
Secretary,

THE WESTERN PACIFIC
RAILROAD COMPANY.

[Endorsed]: Filed Feb. 3, 1949.

PLAINTIFF'S EXHIBIT No. 73

The Western Pacific R.R. Corp. and Affiliates
Summary of Comparative Tax Computations

Year	Return As Filed	Stock Loss Eliminated	Stock Loss Eliminated & Invested Capital Reduced \$25,000,000
1943.....	\$8,566,200	\$9,837,900—
1944.....	1,127,900	1,127,900—

The Western Pacific R.R. Company—8 Mos.—1944 Return
Tax Paid Is \$185,000 Below 80% Maximum

Reduction of Invested Capital Base of Approximately \$4,000,000
Would Produce the 80% Condition.

1943

The W.P.R.R. Corp. and Affiliates

Recomputation of Consolidated Income and Excess Profits Tax
Liability on Basis of the Elimination of Sec. 23(g) Stock Loss

Item No.

1.	Consol. Adjusted Net Income per Return as filed	\$55,093,108.70
2.	Add Stock Loss Deduction	73,116,400.00
3.	Adj. Net Income (before Stock Loss)	18,023,291.30
4.	Add 50% of Int. on Borrowed Capital	1,594,966.23
5.	Dividends Rec'd	108.00
6.	Consol. Excess Profits Net Income	19,618,149.53
7.	Deduct Excess Prof- its Credit	\$8,573,153.33
	Specific Exemption....	5,000.00
8.	Unused Credit (1941)	8,474,200.00
9.	Adjusted Excess Profits Net Income	2,565,796.20
10.	Consol. Excess Profits Tax @ 81% (Net)	\$2,078,300—
11.	Consol. Normal-Tax Net Income (3-9)	\$15,447,495.10
12.	Consol. Normal-Tax @ 42%	6,487,900—
	Consol. Total Tax Liability	\$8,566,200

Note:

80% Max. not applicable.

.80 × \$18,023,291.30 = \$14,400,000.

1943

The W.P.R.R. Corp. and Affiliates

Recomputation of Consol. Income and Excess Profits Tax Liability on
Basis of Elimination of Stock Loss and Reduction of
Invested Cap. Base—\$25,000,000

Item No.

1.	Con. Adj. Net Income (before Stock Loss)	\$18,023,291.30
2.	Con. E. P. Net Income	19,618,149.53
3.	Deduct:	
	E. P. Credit	\$7,073,153.33
	Specific Ex.	5,000.00
4.	Unused Credit	6,724,200.00 13,802,353.33
5.	Con. Adj. E. P. Net Income	5,815,796.20
6.	Con. E. P. Tax @ 81% (Net)	\$4,710,800—
7.	Con. Normal-Tax Net Income (1-5)	12,207,495.10
8.	Con. Normal-Tax @ 42%	5,127,100—
	Consol. Total Tax Liability	<u>9,837,900</u>

Note: The increase in tax liability over the computation on Sheet 1 reflects a total reduction of Inv. Cap. of \$50,000,000—the carryover and the current year

$$\begin{array}{l}
 \text{1941 Carryover} \qquad \qquad \text{Current} \\
 [(7\% \times 25,000,000) + (6\% \times 25,000,000)] \times \\
 \text{Tax Rate} \\
 \text{Differential} \\
 [81\% - 42\%] = \$1,271,700.
 \end{array}$$

1944

The W.P.R.R. Corp—12 Mos.

Affiliates—4 Mos.

Recomputation on Basis of Elimination of Net Operating Loss
Attributable to 1943 Stock Loss

Item No.

1.	Consol. Adj. Net Income per Return as filed	\$42,403,256.08
2.	Add: Net Oper. Loss Deduction....	<u>45,088,695.18</u>

3.	Consol. Adj. Net Income (before N. Oper. Loss)	2,685,439.10
4.	Add 50% of Int. on Borrowed Cap.	526,244.29
5.	Dividends Rec'd	116.00
6.	Consol. E. P. Net Income	3,211,567.39
7.	Deduct: E. P. Credit	\$5,710,848.31
	Spec. Exemption	5,000.00
8.	Unused Credit	5,715,848.31
9.	Consol. Adj. E. P. Net Income.....	.....
10.	Consol. E. P. Tax .....	.....
11.	Consol. Normal-Tax Net Income (Item 3)	2,685,439.10
	Consol. Normal-Tax @ 42%	1,127,900—
	Consol. Total Tax Liability	1,127,900—

1944

The W.P.R.R. Corp.—12 Mos.

Affiliates—4 Mos.

Recomputation on Basis of Elimination of Net Operating Loss and
Reduction of Invested Capital Base in Amount of \$25,000,000
Excess Profits Credit is then reduced to \$4,960,000. Which is still
sufficient to insulate against E. P. Liability and the total tax remains
unchanged from computation on Sheet 3.

1944

The W.P.R.R. Company

8 Mos.—May 1 to Dec. 31, 1944

Surtax Net Income	\$8,866,205—	80%
Maximum Tax Payable	\$7,092,728.64	
Tax Paid—per returns—E. P. Tax	\$5,706.661—	
Before post war refund—Normal.....	1,200,737	6,907,398.00
Margin of Tax	\$ 185,330.64	
$\$185,330.64 \div 90\% = \$206,000 = \text{Income Margin.}$		
$\$206,000 \div 5\% = \$4,120,000 \text{ Invested Capital Margin before}$		
80% Max. applies.		

Sched. I
The W.P.R.R. Corporation and Its Affiliated Companies
Estimate of Federal Income and Excess Profits Tax Liability
Jan. 1 to April 30, 1944

Item No.	Consolidated Return—Parent Full Year, Affiliates Jan. 1 to April 30, 1944		Operating Loss (Sec. 23(g) (4) Not Considered			
Inv. Capital Base—Per Books			Invested Capital "Floor"			
			Before Wage Adj. Deduction	After Wage Adj. Deduction	Before Wage Adj. Deduction	After Wage Adj. Deduction
Estimated Net Income, before taxes, Separate Return Basis						
1.	The Western Pacific Railroad Corporation [est. 12 mos. deficit].....	[\$ 105,000—]				
2.	The Western Pacific Railroad Company [act. 4 mos. figure].....	\$ 3,871,250—				
3.	Deduct: Retroactive Wage Adjustment.....	1,064,250—	2,807,000—			
4.	Sacramento Northern Railway [4 mos. actual figures].....	[328,600—]				
5.	Tidewater Southern Railway.....	28,100—				
6.	Combined Taxable Net Income.....	2,401,500—				
Add: Intercompany Interest Deductions.....						
7.	Corporation Advances to Company.....	92,000—				
8.	Sacramento Owning to Company on Bonds, Notes and Advances.....	248,100—				
9.	Sacramento Owning to Corporation.....	14,200—				
10.	Company Owning to Corp.—1st Mtg. Bonds.....	99,600—	453,900—			
11.	Consolidated Taxable Net Income.....	2,855,400—	\$3,919,650—	\$2,855,400—	\$3,919,650	\$2,855,400—
12.	Deduct: Consol. Net Operating Loss Deduction.....	55,093,000—				
	Less: Adj. Under Sec. 122(d).....	55,093,000—				
13.	Consolidated Taxable Net Income (after Net Oper. Loss Deduction).....	[52,237,600—]	3,919,650—	2,855,400—	3,919,650	2,855,400—
Add: ½ of interest on Borrowed Capital—						
14.	W.P.R.R. Company—½ (\$1,563,000—).....	\$521,000—				
15.	Less: Corp's holding—4 mos. (½ × \$99,600).....	49,800— 471,200—				
16.	W.P.R.R. Corp. (int. on loans).....	51,000—	522,200—	522,200—	522,200—	522,200—
17.	Adj. of Net Operating Loss—Inv. Cap. Basis.....	1,596,000—				
18.	Consolidated Excess Profits Net Income.....	[50,119,400—]	4,441,850—	3,377,600—	4,441,850—	3,377,600—
19.	Deduct: Specific Exemption.....	10,000—	10,000	10,000—	10,000—	10,000—
20.	Consol. Excess Profits Credit.....	6,375,000—	6,375,000—	6,375,000—	3,274,000—	3,274,000—
21.	Consol. Unused Excess Profits Credit Adj. (1943 Carryover).....	8,570,000—	14,955,000			
			6,385,000	6,385,000—	3,284,000—	3,284,000—
22.	Consolidated Adjusted Excess Profits Net Income.....	[65,074,400—]			1,157,850—	93,600—
23.	Consolidated Excess Profits Tax—95% × Item 22.....				1,099,950—	88,920—
24.	Consolidated Normal-Tax Net Income (Item 13 minus Item 22).....	[52,237,600—]	3,919,650—	2,855,400—	2,761,800—	2,761,800—
25.	Consolidated Normal-Tax and Surtax—42% of Item 24.....		1,646,250—	1,199,300—	1,159,950—	1,159,950—
26.	Total Federal Income and Excess Profits Tax Liability (Item 23 + Item 25).....		1,646,250—	1,199,300—	2,259,900—	1,248,870—

Red Figures in Brackets.

[Endorsed]: Filed Feb. 9, 1949.

PLAINTIFF'S EXHIBIT No. 74

The Western Pacific Railroad Company

Western Pacific Building,
526 Mission Street,
San Francisco 5, California.

Air Mail

November 8, 1943.

File B-29-1.

Mr. James K. Polk,
c/o Whitman, Ransom, Coulson and Goetz,
40 Wall Street,
New York, New York.

Dear Mr. Polk:

I am enclosing copy of a computation I have made for an estimate of the year 1943 Federal income and excess profits taxes for the consolidated group for the purpose of arriving at a figure to base our estimated tax accruals upon for the remainder of the current year. Will you be so kind as to have this computation check up and let me know, as soon as you conveniently can, whether there is anything about the principle or fixed figures I have used which is wrong.

The figures shown for "Taxable Net Income" are, of course, purely estimates but they appear conservative at the present time. However, there are many elements which may affect them to a more or less degree so they will be subject to revisions, either up

1810 *Western Pacific R.R. Corp., et al., vs.*

or down, before we close our accounts for the year and whatever changes we find necessary there will correspondingly affect our tax accruals.

Yours truly,

/s/ D. C. DeGRAFF,
General Auditor.

[Endorsed]: Filed Feb. 9, 1949.

The Western Pacific Railroad Company

Estimated Federal Income and Excess Profits Tax—Year 1943

Estimated Consolidated Taxable Net Income, Before Inter-Company Eliminations	
The Western Pacific Railroad Corporation	\$ 353,000
The Western Pacific Railroad Company	17,710,000
Sacramento Northern Railway	618,179
Tidewater Southern Railway Company	35,000
Delta Finance Company, Ltd.	4,000
The Western Realty Company	2,000
Standard Realty and Development Company	6,000
	<hr/>
Total	\$16,781,821

[Italicized figures shown in red]

Add

Inter-Company Eliminations

Interest on First Mortgage Bonds of The W.P.R.R. Co. held by The W.P.R.R. Corp.	\$299,400
Interest on Advances from The W.P.R.R. Corp. to The W.P.R.R. Co.	274,736
Interest on Advances from The W.P.R.R. Corp. to Sacramento Northern Railway	42,813
Interest on Bonds, Notes and Advances of Sacramento Northern Railway held by The W.P.R.R. Co.	750,366
Interest on Advances from The Western Realty Company	2,500
Amortization of Discount on First Mortgage Bonds held by The W.P.R.R. Corp.	9,364
	<hr/>
	1,379,179

Estimated Consolidated Normal Tax Net Income	\$18,161,000
Net Short Term Capital Gain	None
Adjustment of Net Operating Loss Deduction	None
50% of Interest on Borrowed Capital	1,581,000
Total.....	<u>\$19,742,000</u>
Deductions	None
Estimated Consolidated Excess Profits Net Income	\$19,742,000
Estimated Excess Profits Credits	
Invested Capital Estimated same as for year 1942.....	\$147,088,200
\$5,000,000 at 8%	400,000
5,000,000 at 7%	350,000
137,088,200 at 6%	8,225,292
Specific Exemption	5,000
Unused Excess Profits Credit (from 1941)	9,103,360
Total Estimated Excess Profits Credits	<u>\$18,083,652</u>

Estimated Excess Profits Tax Computation		
Estimated Excess Profits Tax Net Income		\$19,742,000
Less Estimated Excess Profits Credits		18,083,652
		<hr/>
Estimated Adjusted Excess Profits Net Income		\$ 1,658,348
90% of \$1,658,348	\$ 1,492,513	
		<hr/>
Estimated Net Income		\$18,161,000
Estimated Surtax Net Income		18,161,000
80% of \$18,161,000		14,528,800
Estimated Normal Tax and Surtax Net Income		
Less Adjusted Excess Profits Net Income	\$18,161,000	
	1,658,348	
	<hr/>	
	\$16,502,652 @42%	6,931,114
		<hr/>
Excess of 80% of Surtax Net Income over Income Tax		\$ 7,597,686
90% of Estimated Adjusted Excess Profits Net Income		1,492,513
Less Credits for debt retirement—10%		149,251
		<hr/>
Estimated Excess Profits Tax Due		\$ 1,343,262
Net Post-War Refund		None

The Western Pacific Railroad System

Statement Showing Distribution of Income as It Would Be Under
Reorganization Plan, if Effective January 1, 1939
Estimated for Calendar Year 1943

	System
Estimated Total Railway Operating Revenues	\$52,900,000
Net Railway Operating Income	\$12,824,000
Add Other Income	582,000
Deductions from Income—Miscellaneous	178,000
Income Available for Fixed Charges	\$13,228,000
Less Rent for Leased Road & Equipment....\$	3,600
Less Interest on Equipment Obligations.....	89,400
Less Interest on Trustees' Certificates (c)....	135,000
Less Amort. of Disc. on Equip. Obligations	4,500
Less Other Miscellaneous Fixed Charges	5,000
	237,500
Available Net Income as Defined by Plan.....	\$12,990,500
Maximum Capital Fund	\$500,000
Less Oper. Exp. System Road Retirements	50,000
Less Oper. Exp. Amort. Road	
Defense Projects	130,000
Less Road Property Depreciation	400,000
Income Available for Interest on Income Bonds	\$12,990,500
Less full $4\frac{1}{2}\%$ interest on \$20,887,888	
Income Bonds (b)	939,955 (
Income Available for Sinking Fund on Income Bonds....	\$12,050,545 (
Less Sinking Fund ($\frac{1}{2}\%$ on \$20,887,888	
outstanding (b)	104,439 (
Less $4\frac{1}{2}\%$ on \$331,187 Bonds previously	
redeemed (b)	14,903 (
1943 Income Available for Other Corporate Purposes or	
for Dividends on Stocks.....	\$11,931,203 (

Notes

Income Taxes: As of this date, The System Railroad Companies, constituted during 1943, expect to accrue estimated Federal Income taxes of \$6,931,000 and estimated Excess Profits taxes of \$1,343,000 a total of \$8,274,000. All income figures on the above statement: after such accruals.

Wages: No accounting in above figures for wage increases which may be authorized or for Land Grant *rate reserves* or *maintenance reserves*.

Note A: If any changes are made in original Plan total amount of \$21,219,075 face value of Income Bonds as finally issued to Railroad Credit Corporation, all amounts marked "A" will be modified. The original unpaid interest claim of the R.C.C. (\$146,503) has been materially reduced each year by credits from the Marshalling and Distributing Plan and other payments. These payments will effect reductions in amounts of securities finally issued to Railroad Credit Corporation and effect the totals of certain securities issued under the Plan. (See I.C.C. Plan—Section P-4.)

Note B: Based on amount of \$20,887,888 for value of Income Bonds outstanding January 1, 1943, as it would be after purchases of \$316,673 face value of such bonds by Sinking Fund of 1940-1941-1942 and \$14,444 face value of such bonds purchased from "interest" at $4\frac{1}{2}\%$ on amount equal to face value of all bonds retired by Sinking Fund operations of years prior to 1943.

Note C: Net interest paid on outstanding Trustees' Certificates after deducting 4% on amount of \$6,000,000 cash collateral on deposit with Reconstruction Finance Corporation.

RR Co Ex 898 A

Office of the President,
San Francisco, California,
November 13, 1943 (EWE)

[Endorsed]: Filed Feb. 9, 1949.

PLAINTIFF'S EXHIBIT No. 76

The Western Pacific Railroad Company

Journal

Month of December 1943

Folio

No.

Debit

Credit

402 Acct. 767—U.S. Government—Federal Income Taxes\$7,069,052.00

To

580 Acct. 532 C—Railway Tax Accruals\$7,069,052.00

To reverse over-accruals of Federal Income and Excess Profits Taxes

for the years 1942 and 1943 as follows:

Year 1942\$ 9,886.13

Year 1943 7,059,165.87

\$7,069,052.00*

* Contingent Liability for this amount will appear on General Balance Sheet as of December 31, 1943, and subsequent months.

I hereby certify that the above entry is correct

/s/ C. P. RUSSELL

Ass't. General Auditor

Approved for Entry

/s/ D. C. DeGRAFF

General Auditor

Month Dec. 1943

Number 1536

The Western Pacific Railroad Company
Journal

Folio No.		Month of January 1944	
		Debit	Credit
592	Acct. 541-P Joint Facility Rents..... For this company's proportion of the following rents accruing during the month of January 1944.	\$1,993.74	
396	Acct. 766—Accrued Interest on Bonds of The Salt Lake City Union Depot and Railroad Co.		\$1,160.41
397	Acct. 766—Sinking Fund for Redemption of Bonds of The Salt Lake City Union Depot and Railroad Company.....		833.33
	Interest		
	Bonds outstanding 1/1/44		\$557,000.00
	Interest on \$557,000.00 January 1944, One month @ 5% per annum \$2,320.83		
	This Company's Prop. 1/2 of		2,320.83
	Sinking Fund		
	November 1, 1943, to October 31, 1944		\$ 20,000.00
	Less D.&R.G.W. Prop. 50%		10,000.00
	The Western Pacific RR Co's Prop. 50%		\$ 10,000.00
	January 1944 Prop. 1/12th of \$10,000.00		
			833.33
			<u>\$1,993.74</u>

354	Acct. 761—Hospital Fund	166.36	
581	Acct. 532-C—Railway Tax Accruals	1,055,706.35	
600	Acct. 544—Miscellaneous Tax Accruals	4,933.33	
	To		
402	Acct. 767—U.S. Govt.—Federal Income Taxes.....		893,000.00
422	Acct. 767—Accrued Tax Liability—State Counties and Cities		82,669.81
418	Acct. 767—U.S. Govt.—Carriers Taxing Act of 1937— Employers Proportion		44,270.84
423	Acct. 767—U.S. Govt.—Railroad Unemployment Insurance Act.....		40,865.39
	Accrued Taxes for the month of January 1944		
	California	\$ 58,836.81	
	Nevada	18,000.00	
	Utah	5,833.00	82,669.81
	Railroad Unemployment Insurance Act		40,865.39
	Carriers Taxing Act of 1937		44,270.84
	Federal Income Taxes		893,000.00

I hereby certify that the
above entry is correct

/s/ C. P. RUSSELL
Ass't. General Auditor

Approved for Entry

/s/ J. R. WENDT
General Auditor

Month Jan. 1944

Number 1553

Journal

Western Pacific R.R. Company, etc.

1821

Folio No.	Month of March 1944	Debit	Credit
592	Acct. 541-P Joint Facility Rents.....		
	For this company's proportion of the following rents accruing during the month of March 1944.	\$1,993.74	
394	Acct. 766—Accrued Interest on Bonds of The Salt Lake City Union Depot and Railroad Co.		\$1,160.41
397	Acct. 766—Sinking Fund for Redemption of Bonds of The Salt Lake City Union Depot and Railroad Company.....		833.33
	Interest		
	Bonds outstanding 3/1/44		\$557,000.00
	Interest on \$557,000.00 March 1944,		
	One Month @ 5% per annum \$2,320.83		
	This Company's Prop. 1/2 of		2,320.83
	Sinking Fund		
	November 1, 1943, to October 31, 1944.....		\$ 20,000.00
	Less D.&R.G.W. Prop. 50%		10,000.00
	The Western Pacific RR Co's Prop. 50%		\$ 10,000.00
	March 1944 Prop. 1/12th of \$10,000.00		
			833.33
			<u>\$1,993.74</u>

354	Acct. 761—Hospital Fund	184.40	
581	Acct. 532-C—Railway Tax Accruals	1,133,716.39	
600	Acct. 544—Miscellaneous Tax Accruals	4,933.33	
	To		
402	Acct. 767—U.S. Govt.—Federal Income Taxes		932,300.00
422	Acct. 767—Accrued Tax Liability—State Counties and Cities		81,969.81
418	Acct. 767—U.S. Govt.—Carriers Taxing Act of 1937— Employers Proportion		64,773.44
423	Acct. 767—U.S. Govt.—Railroad Unemployment Insurance Act		59,790.87
	Accrued Taxes for the month of March 1944		
	California	\$ 58,136.81	
	Nevada	18,000.00	
	Utah	5,833.00	81,969.81
	Railroad Unemployment Insurance Act		59,790.87
	Carriers Taxing Act of 1937		64,773.44
	Federal Income Taxes		932,300.00

Month Mar. 1944

Approved for Entry

I hereby certify that the
above entry is correct

/s/ C. P. RUSSELL
Ass't. General Auditor

/s/ J. R. WENDT

/s/ D. C. DeGRAFF
General Auditor

Number 1610

The Western Pacific Railroad Company

Journal

Folio No.		Month of April 1944	
		Debit	Credit
592	Acct. 541-P Joint Facility Rents..... For this company's proportion of the following rents accruing during the month of April 1944.	\$1,993.79	
394	Acct. 766—Accrued Interest on Bonds of The Salt Lake City Union Depot and Railroad Co.		\$1,160.45
397	Acct. 766—Sinking Fund for Redemption of Bonds of The Salt Lake City Union Depot and Railroad Company.....		833.34

Interest

Bonds outstanding 3/1/44	\$557,000.00
Interest on \$557,000.00 April 1944, one month @ 5% per annum \$2,320.83	
This Company's Prop. 1/2 of.....	2,320.83

1,160.45

Sinking Fund

November 1, 1943, to October 31, 1944	\$ 20,000.00
Less D.&R.G.W. Prop. 50%	10,000.00
The Western Pacific RR Co's Prop. 50%	\$ 10,000.00
April 1944 Prop. 1/12th of \$10,000.00	

833.34

1,993.79

354	Acct. 761—Hospital Fund	173.69	
581	Acct. 532-C—Railway Tax Accruals	1,483,896.87	
600	Acct. 544—Miscellaneous Tax Accruals	4,933.33	
	To		
402	Acct. 767—U.S. Govt.—Federal Income Taxes		1,282,700.00
422	Acct. 767—Accrued Tax Liability—State Counties and Cities		92,369.81
418	Acct. 767—U.S. Govt.—Carriers Taxing Act of 1937— Employers Proportion		59,245.72
423	Acct. 767—U.S. Govt.—Railroad Unemployment Insurance Act		54,688.36
	Accrued Taxes for the month of April 1944		
	California	\$ 68,536.81	
	Nevada	18,000.00	
	Utah	5,833.00	92,369.81
	Railroad Unemployment Insurance Act		54,688.36
	Carriers Taxing Act of 1937		59,245.72
	Federal Income Taxes		1,282,700.00

I hereby certify that the
above entry is correct

/s/ C. P. RUSSELL
Ass't. General Auditor

Approved for Entry

/s/ D. C. DeGRAFF
General Auditor

Month Apr. 1944

Number 1642

[Endorsed]: Filed Feb. 9, 1949.

The Western Pacific Railroad Corporation and Its Affiliates

Federal Income Taxes and Excess Profits Taxes on a Separate Return Basis
(Using Data as Actually Shown in Consolidated Returns Filed)

Western Pacific R.R. Company, etc.

1825

	Year 1942	Year 1943	Period January 1 to April 30, 1944	Total
The Western Pacific Railroad Corporation:				
Excess profits tax	None	None	None	
Income tax	None	None	None	
Total.....	None	None	None	None
The Western Pacific Railroad Company:				
Excess profits tax	\$4,713,594.03	\$10,415,729.54	\$1,295,616.56	
Income tax	2,170,104.09	2,167,612.77	583,910.25	
Total.....	6,883,698.12	12,583,342.31	1,879,526.81	\$21,346,567.24
Sacramento Northern Railway:				
Excess profits tax	None	None	None	
Income tax	127,527.71	51,696.87	None	
Total.....	127,527.71	51,696.87	None	179,224.58
Tidewater Southern Railway Company:				
Excess profits tax	None	None	None	
Income tax	55,907.03	19,843.16	2,460.73	
Total.....	55,907.03	19,843.16	2,460.73	78,210.92

	Year 1942	Year 1943	Period January 1 to April 30, 1944	Total
Deep Creek Railroad Company:				
Excess profits tax	None	None	None	
Income tax	None	None	None	
Total.....	None	None	None	None
The Western Realty Company:				
Excess profits tax	None	None	None	
Income tax	6,168.43	4,562.82	507.75	
Total.....	6,168.43	4,562.82	507.75	11,239.00
Standard Realty and Development Company:				
Excess profits tax	None	None	None	
Income tax	124.83	2,869.97	40.39	
Total.....	124.83	2,869.97	40.39	3,035.19
Delta Finance Company:				
Excess profits tax	910.57	None	None	
Income tax	2,265.06	906.15	None	
Total.....	3,175.63	906.15	None	4,081.78
Grand Total:				<u>\$21,622,358.71</u>

The Western Pacific Railroad Corporation and Its Affiliates

Federal Income and Excess Profits Taxes on a Separate Return Basis (using data as actually shown in consolidated returns filed, and giving each affiliate the benefit of any operating loss carryover or unused excess profit credit carryover attributable to it, though contrary to Reg. 110, Sec. 33.31 (e) and (f).)

Western Pacific R.R. Company, etc.

1827

	Year 1942	Year 1943	Period January 1 to April 30, 1944	Total
The Western Pacific Railroad Corporation:				
Excess profits tax	None	None	None	
Income tax	None	None	None	
Total.....	None	None	None	None
The Western Pacific Railroad Company:				
Excess profits tax	None	\$ 4,180,935.84	\$1,295,473.65	
Income tax	\$4,322,492.75	5,246,929.22	526,799.08	
Total.....	4,322,492.75	9,427,865.06	1,822,272.73	\$15,572,630.54
Sacramento Northern Railway:				
Excess profits tax	None	None	None	
Income tax	2,969.74	51,675.45	None	
Total.....	2,969.74	51,675.45	None	54,645.19
Tidewater Southern Railway Company:				
Excess profits tax	None	None	None	
Income tax	55,907.03	19,843.16	2,460.73	
Total.....	55,907.03	19,843.16	2,460.73	78,210.92

	Year 1942	Year 1943	Period January 1 to April 30, 1944	Total
Deep Creek Railroad Company:				
Excess profits tax	None	None	None	
Income tax	None	None	None	
Total.....	None	None	None	None
The Western Realty Company:				
Excess profits tax	None	None	None	
Income tax	6,168.43	None	299.42	
Total.....	6,168.43	None	299.42	6,467.85
Standard Realty and Development Company:				
Excess profits tax	None	None	None	
Income tax	None	2,869.97	40.39	
Total.....	None	2,869.97	40.39	2,910.36
Delta Finance Company, Ltd.:				
Excess profits tax	None	None	None	
Income tax	349.42	906.15	None	
Total.....	349.42	906.15	None	1,255.57
Grand Total:				<u>\$15,716,120.43</u>

Basis Three

The Western Pacific Railroad Corporation and Its Affiliates
Federal Income Taxes and Excess Profits Taxes on Basis of Consolidated Returns
as Filed But Excluding Corporation's Stock Loss

	Period January 1 to*			Total
	Year 1942	Year 1943	April 30, 1944	
Excess profits tax.....		\$2,078,294	\$1,115,447	\$ 3,193,741
Income tax	\$4,201,821	6,492,109	579,903	11,273,833
	<u>\$4,201,821</u>	<u>\$8,570,403</u>	<u>\$1,695,350</u>	<u>\$14,467,574</u>

* Corporation's excess profits credit for 1944 prorated.

[Endorsed]: Filed Feb. 9, 1949.

DEFENDANT'S EXHIBIT No. 1

To record transfer of ownership of the capital stock to the Reorganization Committee of the Western Pacific Railroad Company, in accordance with request of the said Committee made under and pursuant to order dated December 17, 1943, of the District Court of the United States for the Northern District of California, Southern Division, and also under and pursuant to agreement dated November 22, 1943, between the Western Pacific Railroad Corporation, its secured creditors and said Reorganization Committee, in respect of which approval of the stockholders was given at special meeting held on April 20, 1944.

[Endorsed]: Filed Feb. 4, 1949.

DEFENDANTS' EXHIBIT No. 2

4/20/44

Memorandum Entry

Loss as result of reorganization of subsidiary:

Capital Stock—The Western Pacific Railroad Company.

To record transfer of ownership of the capital stock to the Reorganization Committee under Plan of Reorganization of the Western Pacific Railroad Company, pursuant to order of the Federal District Court for the Northern District of California, dated December 17, 1943, and also under and pursuant

to an Agreement, dated November 22, 1943, between The Western Pacific Railroad Corporation, its secured creditors and said Reorganization Committee and approval of the stockholders of The Western Pacific Railroad Corporation given at special meeting held April 20, 1944.

[Endorsed]: Filed Feb. 4, 1949.

DEFENDANTS' EXHIBIT No. 3

New York, February 5, 1935.

Mr. Schumacher:

In re the Corporation's situation in connection with proposed recapitalization of The Denver and Rio Grande Western Railroad Company and the Western Pacific Railroad Company:

We have prepared a statement showing new set-up of assets of the Corporation, if and when the present proposals for readjustments of the two companies mentioned become effective. There are two statements herewith:

(1) Securities Assignable by Proposed Readjustment of Capitalization of the Western Pacific Railroad Company and The Rio Grande Western Railroad Company in Exchange for Existing Securities Owned and List of Other Assets Owned Remaining Undisturbed.

(2) Schedule of Securities Owned if Proposed Readjustment of Capitalization of The Western Pacific Railroad Company and The

Defendants' Exhibit No. 3—(Continued)

Denver and Rio Grande Western Railroad Company is effected.

The income to the Corporation, which, as you know is entirely from interest received from securities owned, will be very materially reduced, as you will note from Statement #2. The income from the first mortgage bonds received in exchange for certain of the Corporation securities on the basis proposed would amount to approximately \$190,000. However, the income will, no doubt, be increased through income derived from income bonds in the contingent class. I believe it is safe to assume we would get some return from the Incomes, inasmuch as the annual fixed interest set up for both companies based on their net income, even in the poorest year, 1932, was earned. The years '33 and '34 had net income more than sufficient to take care of the proposed First Mortgage Bonds and if business conditions continue to show an upward trend, there should be earnings applicable to the income bonds.

We must also not overlook the fact that the Corporation's loans with The Chase National Bank, Curtiss Southwestern Company and Central Hanover Bank amount to \$9,299,850. The interest per annum on these amounts to approximately \$467,000 being 5% of The Chase and Curtiss and 4½% on the Central Hanover. In addition, our general expenses including taxes, salaries, transfer and registry fees, and office expenses, amount to approximately \$60,000 per year. This is a total of approxi-

Defendants' Exhibit No. 3—(Continued)

mately \$527,000 per annum covering general expenses and interest on loans.

From the above it will be seen that we will be considerably short of our requirements for meeting this overhead.

As I see it from a Corporation viewpoint, if we are to carry on, we should endeavor to get our creditors to declare a moratorium on interest payments for possibly two years with the understanding that, if there is income applicable to payment of such interest, it will be paid.

An Agreement on the part of the said creditors to reduce the interest on their loans to $2\frac{1}{2}\%$ would not see us through as the charge would be in excess of our receipts.

Another thing in connection with this is that under the Railroad Company's proposal Preferred Stock of the operating company is to be distributed to First Mortgage Bondholders as a bonus in the proportions of 25% of principal amount of First Mortgage Bonds held and 100% of 1934 deferred interest on such bonds. As all of this stock, as well as the common, is owned by the Corporation, if such an arrangement is affected, it will be necessary to call special meeting of stockholders to approve it.

M. J. CURRY.

[Marginal note]: Noted and discussed by Mr. Schumacher, 2/11/35.

		of
and The Denver & Rio Gran		
l Remaining Undisturbed		-
The Denver and Rio		00
60%		
General Income		
Mtg. Convertible		
4% Series "A"		
Bds. (Non-Cum.)		
		00
\$ 6,000		
218,400		
\$224,400		00
		00

Defendants' Exhibit No. 3—(Continued)

The Western Pacific Railroad Corporation

Securities Assignable by Proposed Readjustment of Capitalization of The Western Pacific Railroad Company and The Denver & Rio Grande Western Railroad Company in Exchange for Existing Securities Owned and List of Other Assets Owned Remaining Undisturbed

Existing Securities and Other Assets Owned as of December 31, 1934		The Western Pacific Railroad Company				The Denver and Rio Grande Western Railroad Company				
	Amount	Undisturbed	40% 1st. Mtg. 4% Fixed Int. Bonds	60% 1st. Mtg. 4% Adjustment Income Bonds (Cumulative)	4% Preferred Stock (Non-Cumulative)	40% 1st Mortgage 4% Series "A" Bonds	60% General Income Mtg. Convertible 4% Series "A" Bds. (Non-Cum.)	100% Convertible Income Series "A" 5% Notes (Non-Cum.)	1st. Preferred \$5 Participating Stock—No Par (Shares)	Common Stock No Par (Shares)
The Western Pacific Railroad Co.										
1st. Mtg. Bonds 5%—1946	\$11,702,000		\$4,680,800	\$7,021,000	\$2,925,500—25%					
{ Deferred Interest—1934	585,100				585,100—100%					
Preferred Stock	28,300,000		Contributed to Reorganized Company							
Common Stock	47,500,000	\$47,500,000								
Advances	5,639,722		To be cancelled							
The Denver & Rio Grande RR. Co.										
1st. Con. Mtg. Bonds 4%—1936	10,000					\$ 4,000	\$ 6,000			
The Rio Grande Western Ry. Co.										
1st. Con. Mtg. Bonds 4%—1949	364,000					145,600	218,400			
The D. & R.G.W. Railroad Co.										
Rfdg. & Imp. Bonds 6%—1974	1,000,000									
{ General Mtg. Bonds 5%—1955	3,751,875								10,000	
{ Unpaid Interest to 1/1/35	218,855							\$3,751,875		
Preferred Stock 6% (Par \$100)	2,070,000							218,855		
Common Stock (No Par) Shares	150,000								20,700	37,500
Totals.....		\$47,500,000	\$4,680,800	\$7,021,000	\$3,510,600	\$149,600	\$224,400	\$3,970,730	30,700	37,500
Assets Remaining—Undisturbed										
Sacramento Nor. Ry.—Advances	856,260									
Standard R. & D. Co. Advances.....	120,000									
The Western Realty Co.										
*Capital Stk. 3005 Shs. (Book Val.)....	1,500,000									
Tidewater Sou. Rwy. 5%										
1st. Mtg. Bonds—1942	100,000									
The D. & R.G.W. RR. Company										
Note Receivable (Non Interest)	17,500									
The Rio Grande Sou. RR. Co.										
1st. Mtg. Bonds 4%—1940 (In default)	4,000									
Equity in Utah Fuel Co. Capital Stk. 50,000 Shs. (No-Par Value)										

* Subject to \$788,000 loan from The Western Realty Company.

Defendants' Exhibit No. 3—(Continued)

The Western Pacific Railroad Corporation
 Schedule of Securities Owned if Proposed Readjustment of Capitalization of the Western Pacific Railroad Company
 and The Denver and Rio Grande Western Railroad Company Is Effected

		Assured Annual Interest	Contingent Annual Interest
The Western Pacific Railroad Company			
	Par Value		
First Mortgage Fixed Interest Bonds 4%.....	\$ 4,680,800.00	\$187,232.00	
First Mortgage Adjustment Income Bonds 4% (Cum.)	7,021,200.00		\$280,848.00
Preferred Stock—4% (non-cumulative) Par \$100.....	3,510,600.00		
Common Stock	47,500,000.00		
The Denver and Rio Grande Western Railroad Company			
First Mortgage, Series A, Bonds 4%.....	149,600.00	5,984.00	
General Income Mtg. Convertible Series A Bonds, 4% (Non-Cum.)	224,400.00		8,976.00
Convertible Income Series A Notes 5% (Non-Cum.).....	3,970,730.00		198,536.50
First Preferred \$5 Participating Stock—No Par—shs. 30,700			
Common Stock—No Par—shs. 37,500			
Totals.....		<u>\$193,216.00</u>	<u>\$488,360.50</u>
*Interest Charges and General Expenses			
The Chase Chase National Bank of the City of			
New York—Notes 5%	\$ 4,186,000.00	\$212,206.95	
Central Hanover Bank & Trust Company—			
Notes 4½%	635,000.00	28,575.00	
Curtiss Southwestern Company—Notes 5%	4,478,850.00	227,052.85	
Total Interest Expense.....		\$467,834.80	
General Expenses		60,000.00	
Taxes		2,550.00	
Total Interest and General Expenses.....		<u>\$530,384.80</u>	

* Interest on the \$788,000 loan from The Western Realty Company not included.
 O-2/4/35

[In pencil on margin: Balance free funds in Chase Bank 2/1/35 \$140,521.]

Defendants' Exhibit No. 3—(Continued)

The Western Pacific Railroad Corporation

Loans Payable and Supporting Collateral if Proposed Readjustment of Capitalization of The Western Pacific Railroad Company and The Denver and Rio Grande Western Railroad Company Is Effected

Loans

The Chase National Bank City of New York.....\$4,186,000.00

Collateral

\$1,785,600 The W.P.R.R.Co. 1st Mtg. Fixed Int. Bonds 4%
 2,678,400 The W.P.R.R.Co. 1st Mtg. Adj. Inc. Bds. 4% (Cum.)
 1,339,200 The W.P.R.R.Co. Pfd. Stock 4% (Non-Cum.) Par \$100.
 28,700 Shares The D&RGW 1st Pfd. \$5. Participating Stock—
 No Par—(Non-Cum.)
 3,970,730 The D&RGW Convertible Income Series "A" Notes 5%
 (Non-Cum.)

Central Hanover Bank & Trust Company.....\$635,000.00

Collateral

496,800 The W.P.R.R.Co. 1st Mtg. Fixed Int. Bonds 4%
 745,200 The W.P.R.R.Co. 1st Mtg. Adj. Inc. Bds. 4% (Cum.)
 372,600 The W.P.R.R.Co. Pfd. Stock 4% (Non-Cum.) Par \$100.
 149,600 The D&RGW RR. 1st Mtg. Series "A" Bonds 4%
 224,400 The D&RGW RR. Gen'l. Income Mtg. Convertible Series
 "A" Bds. 5% (Non-Cum.)
 11,248.86—Cash on Deposit (Pledged)

Murtiss Southwestern Company\$4,478,850.00

Collateral

2,392,000 The W.P.R.R.Co. 1st Mtg. Fixed Int. Bonds 4%
 3,588,000 The W.P.R.R.Co. 1st Mtg. Adj. Inc. Bds. 4% (Cum.)
 1,794,000 The W.P.R.R.Co. Preferred Stock 4% (Non-Cum.) Par \$100
 2,000 Shares The D&RGW 1st Pfd. \$5. Participating Stock—
 No-Par (Non-Cum.)
 300,500 The Western Realty Co.—Capital Stock—Par \$100.

Defendants' Exhibit No. 3—(Continued)

[Stamped]: T.M.S. Sept. 19, 1938.

Memorandum

September 15, 1938

Mr. Schumacher:

Re: Cash Condition of the Corporation.

Referring to our several discussions recently on the above subject.

Have given serious thought to question of economies that may be effected in connection with operations of the Corporation for the year 1939, and, as a result of such study, I would recommend, for one thing, consideration be given to taking over in this office from the Chase Bank, the work of handling transfer of our stock and incidental services in connection therewith.

Attached is a statement showing cost of services of the Chase National Bank as Stock Transfer Agent for the years of 1926-1937 inclusive.

You will note the total cost over the period covered was \$72,522.39, an average per annum of \$6,043.55.

Of this amount, there are certain charges, such as stationery, printing, binding and postage, upon which no savings can be effected. These items amounted to \$6,436.11 for the period, a per annum average of \$536.34.

Deducting these charges leaves a net amount of possible net savings if the work is handled in this office of approximately \$5500 per annum.

Defendants' Exhibit No. 3—(Continued)

I am satisfied, after discussing this with Mr. Andrews, that he, with the assistance of our other employees, can take on this work and handle it efficiently and expeditiously. If we employed Hatton to do this, in addition to his services as transfer agent for the Denver, it would mean, we would have to place him on some salary with the Corporation, which would have the effect of further reducing the possible savings mentioned above.

If it is decided to do the work in this office, the cost of necessary equipment such as, bookkeeping records, addressograph, file cabinets, etc. cannot be estimated, as we have hesitated to go into the subject with the officer of the Chase Bank who is in charge of our transfer work. If you feel we should contact him to ascertain all facts in connection with this proposal, we will do so. This, of course, would give them advance notice we are contemplating taking the work away from them. Whether or not this would affect our status with the Chase Bank is a question. That is the reason I have hesitated to approach them on the subject, as yet.

I find, the Corporation's By-Laws, under Section 2, Article 5, Capital Stock, it provides:

“The Board of Directors or Executive Committee may provide for registration and transfer of the Capital Stock of the Corporation of both classes in the City of New York, and in such other places within or without the United States as they may

Defendants' Exhibit No. 3—(Continued)

deem advisable and, for such purpose, may appoint the necessary registrars and transfer agents (who may be either Corporation or individuals), and other officers. * * *"

Under the above recited provision, the Board or the Executive Committee can designate who the transfer agent may be. As I understand it, if it is decided we should take this over, we would simply have to notify the Chase Bank, and the Board could designate its office in New York as the Transfer Office.

Another item on which I am certain we can effect a saving, is rental. Our present lease expires May 1, 1939. We are now paying \$7,000 per annum, for approximately 2500 sq. ft., over \$3.00 per foot. In the first place, for our purposes, we do not require that amount of space. I feel that an arrangement can be made with the Chase Bank or for space in some other building in this vicinity, on a basis of \$2.00 a foot, for approximately 2,000 sq. ft. or \$4,000 annual rental, which would be a reduction of \$3,000 from the present rental.

As a matter of information, we have four employees on our Corporation payroll receiving salaries as follows:

	Per Month	Per Annum
Secretary to President	\$187.50	\$2,250.00
Clerk-Accountant	216.66	2,600.00
Stenographer	67.50	810.00
Telephone Operator	55.00	660.00
	<hr/>	<hr/>
	\$526.66	\$6,320.00

Defendants' Exhibit No. 3—(Continued)

Assuming we take over the transfer work and that we will be successful in arranging for sufficient office space at a lesser cost, these two items will result in approximate saving of \$8500 per year.

We are, and have been, for several years, very watchful of the expense of operation of this office, and, in my opinion, it has been kept to the minimum. This, of course, we will continue to do and should any other means of further reducing the cost be discovered, we will take advantage of it.

Another means of reducing the cost of operations is to endeavor to get the Operating Company to bear a larger proportion of the salaries paid to our employees. The division of the total salaries paid at present is approximately 52% by the Corporation and 48% by the Company. These percentages, in my opinion, should be changed, for the reason that a greater portion of time and labor by such employees is being given to Railroad Company matters. We feel the proper division should be 75% Company and 25% Corporation. As you will note from statement above of salaries paid, the total for four employees is \$6320.00 per annum, which, I am sure you will agree, is not comparable to salaries paid generally in other Railroad offices for similar work.

Consideration should also be given to the Railroad Company paying a greater share of the rental. I would suggest, it be divided in the same manner

Defendants' Exhibit No. 3—(Continued)

as suggested for the salaries, that is, 25% by the Corporation and 75% by the Company.

I will discuss with you further at your convenience.

M. J. CURRY.

Defendants' Exhibit No. 3—(Continued)

The Chase National Bank of the City of New York

Charges as Transfer Agent, Common and Preferred Stocks of The Western Pacific Railroad Corporation

	1926	1927	1928	1929	1930	1931	1932	1933	1934	1935	1936	1937	Total for 12 years, 1926/37 inc.	Average for 12 yr. period, 1926/37 inc.
Annual fee	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 500.00	\$ 6,000.00	\$ 500.00
Excess certificates issued	2,229.75	3,176.75	957.25	1,051.50	771.50	633.00	615.00	1,264.95	2,115.40	1,106.00	1,310.05	1,639.05	16,870.20	1,405.85
Excess accounts maintained	5,096.99	3,899.24	3,460.12	3,155.25	2,971.00	2,882.25	2,923.51	2,378.84	2,212.44	2,188.99	2,137.89	2,061.50	35,368.02	2,947.34
Sealing certificates				17.50	17.50		8.75		25.20	7.00	10.50	31.50	117.95	9.83
x Stationery, printing and binding	576.85	110.41	162.38	52.72	70.88	42.81	33.59	72.57	112.89	66.32	107.47	74.99	1,483.88	123.66
x Registered mail and postage	142.12	94.05	24.89	30.95	74.69	67.00	74.76	49.54	49.91	43.55	57.49	50.03	758.98	63.25
Annual report—mailing	172.00	178.75	145.75	188.25	121.00	115.50	121.00	123.75	126.50	129.25	123.75	121.00	1,666.50	138.88
Annual report—postage	163.14	162.87	237.42	213.43	194.99	207.20	194.36	202.55	205.47	210.60	202.46	195.84	2,390.33	199.19
Annual meeting—list	137.50	137.50	127.50	56.25	53.75	52.50	55.00	210.95	210.93	215.63	206.25	207.86	1,671.62	139.30
Annual meeting—proxies	242.50	175.00	175.00	175.00	175.00	175.00	175.00	140.63	123.75	126.50	122.00	119.25	1,924.63	160.39
x Annual meeting—postage	110.02	109.27	101.25	150.00	171.64	124.71	133.53	127.79	128.79	130.91	125.71	122.90	1,536.52	128.04
Special meeting—list											215.63		215.63	17.97*
Special meeting—proxies											152.75		152.75	12.73*
x Special meeting—postage											266.40		266.40	22.20*
Extra list charges			28.00		81.00									
Dividend services	932.25	818.58	234.15									5.00	1,984.98	165.42†
Total Cost handled by the Chase Bank	\$10,303.12	\$9,362.42	\$6,153.71	\$5,590.85	\$5,202.95	\$4,799.97	\$4,834.50	\$5,071.57	\$5,811.28	\$4,724.75	\$5,538.35	\$5,128.92	\$72,522.39	\$6,043.55
Savings that might be effected if handled in this office	\$ 9,310.99	\$8,885.82	\$5,627.77	\$5,143.75	\$4,690.75	\$4,358.25	\$4,398.26	\$4,619.12	\$5,314.22	\$4,273.37	\$4,778.82	\$4,685.16	\$66,086.28	\$5,507.19
x Charges upon which no savings can be effected	\$ 992.13	\$ 476.60	\$ 525.94	\$ 447.10	\$ 512.20	\$ 441.72	\$ 436.24	\$ 452.45	\$ 497.06	\$ 451.38	\$ 759.53	\$ 443.76	\$ 6,436.11	\$ 536.34

*—1 year.

†—3 years.

Defendants' Exhibit No. 3—(Continued)

[Stamped]: T.M.S. Sept. 21, 1938.

Memorandum

New York, September 20, 1938.

Mr. Schumacher:

Referring to my memorandum September 15th re cash condition of the Corporation and comments therein, relative Railroad Company bearing a larger share of salaries of our joint employees:

Your salary, as Trustee and Chairman of the Executive Committee, being fixed by the Court at \$15,000 per annum cannot be changed. All others employed in this office (with one exception mentioned below), including myself, are on the payrolls of the Company and the Corporation.

Mr. James, Chairman of the Board, is on Company payroll at \$5,000 per annum, nothing from the Corporation.

Pierce & Greer, Counsel, are on the payrolls for \$10,000 per annum divided 50/50 between the Corporation and Company.

We have one employee, Miss O'Neill, on Company payroll at \$1,560 per annum, does not receive any salary from the Corporation.

In line with recommendation in memo referred to, I show below the names, salaries paid by Company and Corporation at present, what they would amount to if divided on basis of 75% Company and 25% Corporation, and the totals. It will be noted

Defendants' Exhibit No. 3—(Continued)

the salaries paid now by the Company amount to \$10,700 per annum, whereas, under arrangement suggested this would be increased to \$16,815, a net increase in the Company payroll of \$6,115 per annum.

I cannot help feeling that under the conditions existing at the present time which will, no doubt, continue through 1939 and possibly beyond that, the division of these salaries on basis suggested is justified. If you agree, it might be well to take the question up with Mr. Ehrman to ascertain if he is willing to join you in instructing Mr. Elsey to arrange accordingly.

	Present		Proposed		Total
	Company	Corpn.	Company	Corpn.	
M. J. Curry	\$ 4,500	\$ 5,400	\$ 7,425	\$ 2,475	\$ 9,900
C. E. Andrews	2,420	2,600	3,765	1,255	5,020
W. C. Mittelberg....	2,070	2,250	3,240	1,080	4,320
M. C. Valouch	930	810	1,305	435	1,740
C. C. Sheehan	780	660	1,080	360	1,440
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	\$10,700	\$11,720	\$16,815	\$ 5,605	\$22,420
% of Total.....	47.73	52.27	75.	25.	

M. J. CURRY.

T.M.S.

SEP 21 1938

~~Wm. J. & Helen~~
This will incur Co's

expense \$6.115 per year
how much will this be
incurred by other parties
being open house in building,
rent etc

WJL

RRG 136A
EXHIBIT
3/21/48 E.G.

12-12-16

203A
12

Defendants' Exhibit No. 3—(Continued)

Memorandum

New York, September 21, 1938.

Mr. Schumacher:

Your memorandum attached:

As a partial offset to proposed increase in Company payroll of \$6,115 per annum, we feel certain a saving can be effected beginning May 1, 1939, in our rental. Our present lease with the Chase Bank is on basis \$7,000 per annum divided 50/50 between Corporation and Company. We have approximately 2500 sq. ft. of space, more than we actually need. When question of renewal comes up it is my purpose to request reduction in rental to approximately \$4,000 per annum; failing in that we can, no doubt, secure desirable and adequate space in some other building at that rental. If proposed basis of dividing rental is arranged, that is, 75% to be paid by the Company and 25% by the Corporation, this change in rental will result in a saving of \$3,000, or \$2,500 to the Corporation and \$500 to the Company, over what it is costing at the present time. Applying this saving to the proposed increase in payroll of \$6,115 per annum, would result in a net total increase in cost of operation of this office of \$5,615 per annum.

So far as effecting any savings in our general expenses is concerned, I don't believe anything more can be done as we are now and have been for

Defendants' Exhibit No. 3—(Continued)
several years watching these expenses closely and have brought them down to the minimum.

Below is a recapitulation of expenses for 8 months of this year, January 1 - August 31, 1938, inclusive:

		% of Total
Salaries of officers and clerks	\$24,522.97	78.08
Travelling expenses	2,306.04	7.34
Stationery and printing	107.06	.34
Transfer and registry	1,194.38	3.80
Fees—Executive Committee meetings.....	60.00	.19
General expenses	437.12	1.39
Rent	2,333.36	7.44
Miscellaneous	445.66	1.42
Total.....	\$31,406.59	100.00

An average of approximately \$4,000 per month.

As will be seen from the above—outside of salaries, rent, transfer and registry charges and travelling expenses, our “general and miscellaneous expense” amounts to approximately \$130 per month.

Included in item “General and miscellaneous expense” are the following charges: telephone, telegraph, stationery, printing, Executive Committee fees, postage, subscriptions (Official Guide, Standard Statistics service, Poor’s Railroad Manual, Moody’s Industrial Manual and other railway publications), etc.

Transfer and registry charges cover services of the Chase Bank and Central Hanover Bank in connection with payment of interest on our outstanding Trustees’ and Equipment Trust Certificates.

Defendants' Exhibit No. 3—(Continued)

It is my understanding that while the Company is undergoing reorganization, in order to avoid possibility of some creditor stepping in and taking any funds that might be on deposit here in New York to the credit of the Railroad Company, it was decided to designate these banks as the Paying Agents on the certificates. The same situation exists so far as the D&RGW is concerned. The Trustees have designated the Chase Bank as the Paying Agent on their certificates rather than the office of Hatton, Assistant Secretary and Assistant Treasurer.

When the first issue of \$3,000,000 Trustees' Certificates was sold, question of payment of the principal and interest at maturity was the subject of correspondence between you and Mr. Ehrman. In Mr. Ehrman's letter to you of November 12, 1936, he stated:

"In this connection, we will also have to make arrangements for the payment of outstanding certificates when they come in on January 2nd. I doubt whether we have the facilities at the office to take care of this and would suggest that it be put in the hands of some bank or trust company to whom we could refer certificate holders who present the certificates for payment."

In your reply to Mr. Ehrman, you stated:

"* * * , as the major amount of such certificates are held here in the east, it might be desirable to have them presented to The Chase National Bank

Defendants' Exhibit No. 3—(Continued)
of the City of New York, as Agent, for payment
and they in turn can handle with the Crocker
Bank. * * * "

M. J. CURRY.

[Stamped]: T.M.S. Sept. 26, 1938.

Memorandum

New York, September 23, 1938

Mr. Schumacher:

With further reference to question of the Rail-
road Company bearing a larger share of salaries
of joint employees:

As requested, I show below figures based on the
division of salaries and rental of 66 $\frac{2}{3}$ % Company
and 33 $\frac{1}{3}$ % Corporation, instead of 75% and 25%,
respectively, as suggested in my memo 20th.

	Present		Proposed		
	Company	Corpn.	Company	Corpn.	Total
M. J. Curry	\$ 4,500	\$ 5,400	\$ 6,600	\$ 3,300	\$ 9,900
C. E. Andrews	2,420	2,600	3,347	1,673	5,020
W. C. Mittelberg....	2,070	2,250	2,880	1,440	4,320
M. C. Valouch	930	810	1,160	580	1,740
C. C. Sheehan	780	660	960	480	1,440
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	\$10,700	\$11,720	\$14,947	\$ 7,473	\$22,420
% of Total	47.73	52.27	66 $\frac{2}{3}$	33 $\frac{1}{3}$	

It will be seen that if the Company takes over
the salaries of these joint employees on the sug-
gested percentages, 66 $\frac{2}{3}$ Company and 33 $\frac{1}{3}$ Cor-

Defendants' Exhibit No. 3—(Continued)

poration, it will result in an increase in the Company's New York Office payroll of \$4,247 per annum.

If reduction in rental can be effected, as suggested, this would result in a saving in this item, on basis percentages above-mentioned, of \$834, making a total increase to be assumed by the Company of \$3,413 per annum.

M. J. CURRY.

Memorandum

New York, November 28, 1938

Mr. Schumacher:

After payment of salaries, checks for which are enclosed for your signature, it will leave a balance on deposit with the Chase Bank of \$3,472.88. We have on hand unpaid bills amounting to \$972.28, as follows:

Chase National Bank—Rent and Light.....	\$597.99
Chase National Bank, Services.....	120.11
N. Y. Trust Co., Services	40.35
N. Y. Telephone Co., Phone.....	143.48
Pioneer Warehouses, Rent.....	46.80
Towels	7.10
Water	5.92
Miscellaneous	10.53

\$972.28

Defendants' Exhibit No. 3—(Continued)

I don't believe it is worth while to withhold payment of these bills as the amount is only \$972. However, I should like to have your advice.

If paid, it will leave balance in Chase of \$2,500.60.

M. J. CURRY.

[Marginal Note]: O.K.—T.M.S.

[Endorsed]: Filed Feb. 4, 1949.

DEFENDANT'S EXHIBIT 4A

Memorandum

New York, January 11, 1941

Mr. Schumacher:

In re subject attached letter from Col. Coulson:

As you know, this question has been in our minds for a long time and, at meeting of the Board several months ago, I mentioned it to Mr. Olyphant of the Central Hanover, and handed him a statement (copy attached) showing allocation of new securities, under the approved ICC reorganization plans for the Western Pacific and the D&RGW, in lieu of securities now pledged under loan with his bank, which he said he would be glad to study and, later on, discuss the matter of possible release of the \$11,248 pledged cash. I pointed out to him that the Corporation had been carrying on, during the past few years, through borrowing funds from The Western Realty Company (wholly-owned subsid-

iary), the entire stock of which is pledged under loan with the Curtiss Southwestern Company—the latter company having consented to such borrowing in each instance; that it seemed to me the Central Hanover loan was in far better shape collaterally than those with the Chase Bank and the Curtiss Southwestern Company and I felt that under all the circumstances the Central Hanover could very well release the cash to the Corporation, to enable it to meet its current operating expenses.

I have heard nothing further from him, neither have I broached the subject since, my thought being that at the first meeting of our Board I would again take it up with him.

In view of Mr. Coulson's suggestion, however, perhaps we should take it up formally, by letter. Will discuss this with you at your convenience.

/s/ M. J. C.

[Marginal Note]: Discussed 1/13/41.

[Stamped]: T.M.S. Jan. 13, 1941.

[Endorsed]: Filed Feb. 4, 1949.

DEFENDANTS' EXHIBIT No. 4B

January 14, 1941.

Mr. Robert E. Coulson
40 Wall Street
New York, N. Y.

Dear Mr. Coulson:

I have your letter of the 10th instant, suggesting some investigation be made of the status of the cash which this Corporation has on deposit in the Central Hanover Bank, pledged to secure, in part, our loan, before further advance from the Western Realty Company to the Corporation is made.

The principal of the demand note of this Corporation held by the Central Hanover Bank & Trust Company, dated May 25, 1932, is \$635,000. Interest rate was originally 5%; however, as of February 1, 1935, the rate was reduced to 4½%. This was brought about through conference our Treasurer, Mr. Curry, had with Mr. Olyphant, Vice President of Central Hanover, and in accordance with resolution adopted at meeting of Board of Directors on January 10, 1935, which resolution was as follows:

“Resolved, that the Directors of the Corporation are of the opinion that it is for the best interest of the Corporation to have \$40,000 of said deposit of \$51,248.86 applied by the Central Hanover Bank and Trust Company in part-payment of said loan of \$675,000 and the officers are directed to use their best efforts to induce said bank to make application of said amount and to also endeavor to secure a

reduction of 1% in the present rate of 5% for said loan."

Our records indicate that at the aforementioned conference Mr. Olyphant inquired if we had approached our other two creditors (Chase Bank and Curtiss Southwestern) with like request, and statement was made that we had not, for the reason that their loans were not as well collaterated as the Central Hanover loan and that therefore a reduction from the 5% rate would seem to be fair and reasonable.

The question you raise has been in our minds for a long time and, at a meeting of the Board, several months ago, Mr. Curry mentioned it to Mr. Olyphant and handed him a statement (copy attached, revised to December 31, 1940), showing allocation of new securities under the approved ICC reorganization plans for the Western Pacific and the D&RGW in lieu of securities now pledged with Central Hanover. Mr. Olyphant stated he would be very glad to study it and, later on, discuss with us the matter of possible release of the \$11,248 pledged cash. It was pointed out to him that the Corporation had been carrying on, during the past several years, through borrowing funds from the Western Realty Company, the entire stock of which is pledged under loan with Curtiss Southwestern Company—that company having consented to such borrowing in each instance; that it seemed to us the Central Hanover loan was in much better shape collaterally than those of the other two creditors and

we felt, under all the circumstances, the Central Hanover should be willing to release the cash to the Corporation to help meet current operating expenses.

However, the question has not been pursued further for the reason we have felt the Central Hanover had a right to hold this cash as part collateral under the loan, which has been in default since January, 1934. Aside from this, it is my judgment it is not opportune at this time to take this up with Central Hanover, as I feel they would turn it down, and I prefer to allow it to remain "as is" until actual necessity arises, when the Western Realty Company's cash resources may not be sufficient to permit of further loans to the Corporation.

Yours very truly,

/s/ T. M. SCHUMACHER.

bcc. Mr. F. C. Nicodemus, Jr.

[Endorsed]: Feb. 4, 1949.

DEFENDANTS' EXHIBIT No. 4C

(For Identification Only)

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

August 7, 1941

Mr. T. M. Schumacher,
The Western Pacific Railroad Corporation,
37 Wall Street,
New York, N. Y.

Dear Mr. Schumacher:

Since 1936 there has been advanced to The Western Pacific Railroad Corporation something over \$200,000 by the Western Realty Company. The stock of the Western Realty Company is all held by Curtiss Southwestern Company as collateral for an under-collateralized loan which is in default. The advances have been made possible by formal consents given by the Curtiss Southwestern Company to such advances. During the lifetime of Mr. James these advances represented no problem in view of the ownership of the Curtiss Southwestern Company. Today all the stock in Curtiss Southwestern Company is held by the executors under the wills of Mr. James and of Mrs. James.

We have given consideration to the question whether we could properly advise the executors to consent to the continuance of such advances. We find no basis upon which we may properly give such advice.

As you know, Curtiss Southwestern Company is one of three secured creditors of The Western Pacific Railroad Corporation, the other two being The Chase National Bank of the City of New York and the Central Hanover Trust Company. It is possible that some plan could be worked out for cooperation between the three secured creditors in providing The Western Pacific Railroad Corporation with needed funds on the basis of which some favorable recommendation might be made to the executors of the James' estates. We suggest that you get in touch with the other secured creditors as promptly as you can and obtain their views as to the situation.

Sincerely yours,

/s/ ROBERT E. COULSON.

[Stamped]: T.M.S. Aug. 13, 1941.

[Stamped]: The Western Pacific Railroad Corporation—Received Aug. 11, 1941.

DEFENDANT'S EXHIBIT No. 5A

May 20, 1943.

Messrs. Pierce & Greer
40 Wall Street
New York, N. Y.

Att. Mr. H. Brua Campbell

Dear Mr. Campbell:

The enclosed copies of letters from Tri-Continental Corporation, this city, explain themselves.

Will you please advise as to nature of reply that should be made.

In this connection, I refer you to your letter dated May 21, 1942, to Lybrand, Ross Bros. & Montgomery (copy to me) having reference to question of whether this Corporation is subject to New York State franchise tax. The opinion expressed therein, it seems to me, may also serve as an answer to the inquiry from Tri-Continental.

Yours very truly,

/s/ M. J. CURRY.

[Marginal Note]: Mr. Campbell suggested we make reply stating that the corp. does not file N. Y. State Franchise Tax.

/s/ M. J. C.

5/24/43.

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 5B

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

May 18, 1944

Mr. M. J. Curry, Vice President,
Western Pacific Railroad Company,
37 Wall Street,
New York, N. Y.

Dear Sir:

You have inquired as to the possible liability of The Western Pacific Railroad Corporation for future franchise taxes in the State of New York in view of the prospective changes to be occasioned by the reorganization of The Western Pacific Railroad Company and the transfer of the capital stock of the Railroad Company to the Reorganization Committee.

We understand that you have heretofore been advised by counsel that your corporation was not subject to any State franchise taxes under then existing laws and decisions, in the light of its activities in New York State.

However, since such advice was given, the New York State franchise tax laws have been substantially changed by enactments at the 1944 Session of the Legislature, and, in particular, by Chapter 415 of the Laws of 1944, effective March 31, 1944.

From the present point of view of The Western Pacific Railroad Corporation, the most significant

Defendants' Exhibit No. 5B—(Continued)

change effected by Chapter 415 of the Laws of 1944 is a new definition of "doing business" in New York State, for purposes of franchise taxation. Prior to the enactment of Chapter 415 of the Laws of 1944, the provision under which The Western Pacific Railroad Corporation was deemed not to be doing business in the State for franchise tax purposes (Subdivision 6, Section 188, Tax Law) read as follows:

"The holding of real property in this state by a foreign corporation shall be deemed to be doing business in this state within the meaning of this article, but a foreign corporation shall not be deemed to be doing business in this state, for the purposes of this article, solely by reason of (a) having office furniture and fixtures in this state, or (b) the maintenance of cash balances with banks or trust companies in this state, or (c) the ownership of shares of stock or securities kept in this state, if pledged as collateral security, or, if deposited with one or more banks or trust companies, or with brokers, who are members of a recognized security exchange, in safekeeping or custody accounts, or (d) the taking of any action by any such bank or trust company or broker, which is incidental to the rendering of safekeeping or custodian service to such corporation, or (e) any combination of the foregoing activities."

The provision in the new franchise tax laws (Tax Law, Section 209 (4)) which replaces Section 188,

Defendants' Exhibit No. 5B—(Continued)
subdivision 6, reenacts substantially the above-quoted provision except that the words which we have underscored above were omitted in the new enactment. The omission of clause (a) “having office furniture and fixtures in this state” was undoubtedly intended to bring under the provisions of the New York statute all foreign corporations maintaining offices of their own in the State of New York, and we would anticipate that the maintenance of an office by The Western Pacific Railroad Corporation in the State of New York, after the effective date of the new statute for such purposes, would subject the Corporation to New York State franchise taxes.

Although the new law was effective as of March 31, 1944, under its provisions a company, theretofore deemed not to be doing business in New York State under the prior law, but deemed to be doing business in New York State under the provisions of the new law, would not incur liability for tax prior to the tax period commencing November 1, 1944. The President of the Tax Commission stated the position of the Tax Commission as follows: (Paragraph 13,028-B, Prentice-Hall, State and Local Tax Service):

“ * * * For example, a corporation on the calendar year basis which would be deemed to have commenced doing business in the state on the effective date of the new law would not incur liability for tax under the new law un-

Defendants' Exhibit No. 5B—(Continued)
less it continued doing business in the state
after October 31, 1944 * * *"

It is our opinion that, if The Western Pacific Railroad Corporation continues to maintain an office in New York State and continues its business activities as heretofore, after October 31, 1944, it will thereby subject itself to the provisions of the New York State franchise tax laws.

If you have any other questions in connection with these problems, we should be glad to advise you.

Very truly yours,

WHITMAN, RANSOM,
COULSON & GOETZ.

[Stamped]: Received May 23, 1944, Western Pacific Railroad Co.

May 23, 1944.

Mr. F. C. Nicodemus, Jr.
Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Dear Mr. Nicodemus:

Herewith is copy of letter dated May 18th, from Messrs. Whitman, Ransom, Coulson & Goetz, Tax Counsel of the Railroad Company, which is self-explanatory.

As we are anxious to avoid payment of the tax

Defendants' Exhibit No. 5B—(Continued)
in question, which will begin to accrue as of November 1, 1944, it will be appreciated if you will advise what, if anything should be done to accomplish this result, or, in any event, to enable us to pay a minimum tax.

Yours very truly,

/s/ M. J. CURRY.

[Marginal Note]: MVC to note /s/ M. J. C.
Noted /s/ M. C. V.

Pierce & Greer
40 Wall Street
New York 5, N. Y.

June 14, 1944.

Mr. M. J. Curry, President
The Western Pacific Railroad Corporation
37 Wall Street
New York 5, N. Y.

Dear Mr. Curry:

This will serve as a tardy acknowledgment of your letter to me of May 23, 1944, enclosing opinion from Messrs. Whitman, Ransom, Coulson & Goetz, in respect of the recently enacted New York State franchise tax.

I understand that this tax liability does not begin to accrue until November 1, 1944, by which time we

Defendants' Exhibit No. 5B—(Continued)
are hopeful of disposing of our controversy with
Mr. Buckland. In any event I think it will be
necessary to make this payment in order to enable
The Western Pacific Railroad Corporation to function
at least through the present calendar year.

Yours very truly,

/s/ F. C. NICODEMUS, JR.

[Stamped]: Received June 15, 1944, Western
Pacific Railroad Co.

October 5, 1944.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Referring to our exchange of letters in May and
June, last, in re. New York State Franchise tax:

As this tax will begin to accrue as of November
1, 1944, and the first report is due May 15, 1945,
and the tax shown by such report is payable one-
half at time of filing report and one-half on or
before the succeeding November 15th, I am again
calling it to your attention with request for advice
as to what can be done to avoid payment, in view
of conditions surrounding the Corporation at this
time.

Defendants' Exhibit No. 5B—(Continued)

Do you feel it would be desirable to address a letter to Mr. Rollin Browne, State Tax Commissioner, at Albany, stating the facts, and request a waiver of the obligation under the new law in behalf of the Corporation? If you do, will you please let me have draft of such a letter.

Yours very truly,

/s/ M. J. CURRY.

[Marginal Notes]: President, State Tax Commission.—MCV to note and return /s/ M. J. C.
Noted.

Pierce & Greer
40 Wall Street
New York 5, N. Y.

October 11, 1944.

Mr. M. J. Curry, President
The Western Pacific Railroad Corporation
37 Wall Street
New York 5, N. Y.

Dear Mr. Curry:

Mr. Nicodemus asked me to reply to your letter of October 5, 1944, with reference to the applicability to the Corporation of the franchise tax on business corporations imposed by Article 9-A of the

Defendants' Exhibit No. 5B—(Continued)

New York Tax Law, as amended by Chapter 415 of the Laws of 1944, effective March 31, 1944.

Inasmuch as the tax thereby imposed does not begin to accrue until November 1, 1944, and the first return required to be made by the Corporation will not be due until May 15, 1945, it is our thought that it would not be profitable to do anything in the matter until shortly before the date for the filing of the return, at which time the Corporation will be in a position to deal with the matter in the light of such developments as may hereafter occur.

Yours very truly,

/s/ H. BRUA CAMPBELL.

[Marginal Note]: Noted M. C. V.

[Stamped]: M. J. O. Oct. 13, 1944.

[Stamped]: Received Oct. 31, 1944, Western Pacific Railroad Company.

March 26, 1945.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Referring to enclosed copy of letter dated March 23, 1945, from Tri-Continental Corporation, this city, on subject New York State Franchise Tax:

1870 *Western Pacific R.R. Corp., et al., vs.*

Defendants' Exhibit No. 5B—(Continued)

See your letters to me under dates June 14, 1944, and October 11, 1944, and let me know, please, what I should say in answer to their inquiry.

Yours very truly,

/s/ M. J. CURRY.

[Marginal Notes]: M. C. V. to note and return
/s/ M. J. C.

Noted /s/ M. C. V.

Tri-Continental Corporation

65 Broadway

New York

March 23, 1945

Western Pacific R. R. Corp.

37 Wall St.

New York 5, N. Y.

Dear Sirs:

During the year 1944 the undersigned or certain of its associated companies were the beneficial owners of securities of your corporation. In the preparation of our New York State Franchise Tax report we are required to apportion the value of such securities in accordance with the percentage of the entire capital or the issued capital stock of your corporation allocable to New York State as determined on your New York tax report for the preceding tax year.

Defendants' Exhibit No. 5B—(Continued)

Accordingly, we should appreciate your advising us of the percentage, if any, of the entire capital or the issued capital stock of your corporation allocated to New York State on the New York State Franchise Tax report, if any, filed by your corporation during the year 1944. It will answer our purpose, if you merely fill in such information at the bottom of this letter, or indicate that you do not file New York State Franchise Tax reports.

We shall appreciate an early reply.

Very truly yours,

TRI-CONTINENTAL
CORPORATION,

/s/ WILLIAM RENNER,
Treasurer.

Percentage of entire capital or issued capital stock allocated to New York State on New York State Franchise Tax report filed during the year 1944.

.....%.

.....

Signed.

[Stamped]: Received March 26, 1945, Western Pacific Railroad Co.

Defendants' Exhibit No. 5B—(Continued)

Pierce & Greer
40 Wall Street
New York 5, N. Y.

April 9, 1945

Mr. M. J. Curry, President
The Western Pacific Railroad Corporation
37 Wall Street
New York 5, N. Y.

Dear Mr. Curry:

This refers to your letter of March 23, 1943, enclosing copy of letter from the Tri-Continental Corporation requesting advice as to the percentage of capital stock of The Western Pacific Railroad Corporation allocable to New York State.

My suggestion is that you call Mr. James K. Polk and ascertain whether any of the James Corporations are concerned with the same request that has been made by the Tri-Continental Corporation and be guided by his recommendation as to the answer to be made pursuant to this inquiry.

Yours very truly,

/s/ F. C. NICODEMUS, JR.

[Stamped]: Received April 10, 1945, Western Pacific Railroad Co.

Defendants' Exhibit No. 5B—(Continued)

April 10, 1945

Mr. James K. Polk

Messrs. Whitman, Ransom, Coulson & Goetz

40 Wall Street

New York 5, N. Y.

Dear Mr. Polk:

Enclosed is copy of letter dated March 23, 1945, from Tri-Continental Corporation, this city, on subject of New York State Franchise tax.

I referred this to Mr. Nicodemus, of Counsel for this corporation, for advice as to nature of reply to be made and he suggests I ascertain from you whether any of the James corporations are concerned with the same request that has been made by the Tri-Continental, and advise me, if you will, please, as to answer to be made to the inquiry.

Yours very truly,

/s/ M. J. CURRY.

April 11, 1945.

Tri-Continental Corporation

65 Broadway

New York 6, N. Y.

Attention Mr. William Renner, Treasurer.

Gentlemen:

In response to your letter of March 23rd, this is to advise that the Western Pacific Railroad Cor-

Defendants' Exhibit No. 5B—(Continued)
poration did not file a New York State franchise
tax report during the year 1944.

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. F. C. Nicodemus, Jr.

See your letter of April 9th. The above letter
was written on suggestion made by Mr. Polk
over the 'phone today.

M. J. C.

April 23, 1945.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

I refer you to my letter dated October 5, 1944,
your reply dated October 11, 1944, in regard to the
franchise tax imposed by Article 9-A of the
amended New York Tax law:

As the first return required to be made will be
due May 15, 1945, which date is rapidly approach-
ing, I would appreciate your prompt advice as to
what should be done in the matter so far as the
corporation is concerned.

Mr. Polk, of the firm of Whitman, Ransom, Coul-

Defendants' Exhibit No. 5B—(Continued)

son & Goetz, I understand, has had this question under consideration and I suggest you consult him in the matter.

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. James K. Polk

Whitman, Ranson, Coulson & Goetz.

April 26, 1945.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Referring to my letter to you of April 23rd, in regard to New York State Franchise Tax:

For your information, I quote below item which appeared in this morning's edition of the New York Times:

“Tax Deadline Is Extended

Put Off by State From May 15 to June
15 on Corporate Returns

Albany, April 25 (AP)—The State Tax Commission today extended from May 15 to June 15 the deadline for filing 1944 corporation franchise tax returns.

Defendants' Exhibit No. 5B—(Continued)

The extension affects corporations and those whose fiscal years ended in July, August, September, October or November, 1944, or in January or February, 1945.

Commissioner Rollin Browne said the extra month was granted to permit taxpayers to follow newly adopted regulations, now being printed."

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. James K. Polk.

Whitman, Ransom, Coulson & Goetz.

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 5-C

Moody's Investors Service
65 Broadway, New York

January 8, 1943

Mr. T. M. Schumacher, Trustee,
Western Pacific Railroad Co.,
37 Wall Street,
New York City, N. Y.

Dear Sir:

In analytical work dealing with railroad securities the federal income tax liability (past, present and future) and the correct method of computation

Defendants' Exhibit No. 5-C—(Continued)

based on accurate knowledge of the various basic factors is today more important than ever. We in our work here at Moody's have naturally had to make estimates, but sometimes, due to inadequate knowledge of the facts, our tax conclusions have not been as accurate as we would wish.

We wonder whether you would be willing to be of help to us regarding the above and, on the possibility that you would, we are enclosing a tax form a return of which filled out (even on a tentative basis) would be of great assistance.

We should be glad to hold any information furnished us in confidence, if you so desire.

Yours very truly,

MOODY'S INVESTORS
SERVICE

/s/ WALTER F. HAHN,

Manager-

Railroad Department.

WFH:FD

Enclosure

[Initialed]: MJC & MCV

[Stamped] Received Jan. 9, 1943, W. P. R. R. Co.

[Stamped]: T.M.S. Jan. 11, 1943.

Defendants' Exhibit No. 5-C—(Continued)

Estimate of Excess Profits Tax For 1942

Preferred Stock
Common Stock
Premium on Stock
One half of Debt
Corporate Surplus
Other items of invested capital (explain)
Total Invested Capital
Inadmissible Assets (1)
Total Assets (2)
Ratio of (1) to (2)
Invested Capital Less Inadmissibles
8% on First 5 Million
7% on Second 5 Million
6% on Next 190 Million
5% on Balance
Excess Profits Tax Credit
Pre-Tax Net Income—1942
Less Net Operating Loss Carryover
Less Net from Inadmissibles
Balance
Plus One-Half Interest Charges
Total
Excess Profits Tax Credit plus Carryover
Excess Profits
Excess Profits Tax (90%)

Estimate of Normal Tax and Surtax For 1942

Pre-Tax Net Income—1942
Less Excess Profits

Defendants' Exhibit No. 5-C—(Continued)

Less Net Operating Loss Carryover
Balance
Add Back income from Inadmissables
subject to Normal & Surtax
Total
Normal & Surtax (40%)
Total Normal & Surtax
Pre-Tax Net Income
Less Total Tax
Net Income

Estimate of Unused Excess Profits Credit

	1941	1940
Federal Income Tax Accrual		
Pre-Tax Net Income Indicated		
(1941 tax rate 31%; 1940 tax rate 24%)		
Net Operating Loss Carryover from 1939		
Net Operating Loss Carryover from 1939 & 1940		
Adjusted Net Income		
Plus One-half of Interest Charges		
Total		
Less Net from Inadmissables		
Balance (1)		
8% of First 5 Million of Invested Capital Less Inadmissible Assets		
7% of Balance of Such Assets		
Total Excess Profits Credit		
Balance (1)		
Excess Profits Credit Carryover		

Defendants' Exhibit No. 5-C—(Continued)

January 13, 1943.

Mr. Walter F. Hahn, Manager,
 Railroad Department,
 Moody's Investors Service,
 65 Broadway,
 New York, N. Y.

Dear Sir:

Your letter of January 8, addressed to Mr. T. M. Schumacher, Trustee, has been turned over to the undersigned for reply.

As The Western Pacific Railroad Company is included in the consolidated income and excess profits tax returns filed by The Western Pacific Railroad Corporation (parent company), we show below estimated consolidated figures, of which the Company's Pre-Tax Net Income is \$10,290,278:

Pre-Tax Net Income	\$9,501,492
Less Net Operating Loss Carry-over	1,217,213
	<hr/>
	\$8,284,279
Add Eliminations	1,575,727
	<hr/>
	\$9,860,006
Normal & Surtax (42%)	\$4,141,202
Western Pacific Railroad Company's apportionment of tax	\$4,078,794
Less accrued 1941	384,800
	<hr/>
Accrued in 1942—Estimated	\$3,693,994

Defendants' Exhibit No. 5-C—(Continued)

No provision has been made for accrual of excess profits tax since it appears whatever excess profits net income there may be will be more than offset by the excess profits credit and the unused profits credit carryover.

It will be appreciated if you will treat the above information confidentially.

Yours very truly,

/s/ M. J. CURRY.

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 6

The Western Pacific Railroad Company

Western Union Telegram Form

New York, March 2, 1943

D. C. DeGraff

Western Pacific Railroad Company

526 Mission Street

San Francisco, Calif.

Wire date: At conference with accountants here yesterday decided file consolidated tax returns including subsidiaries you list. In view this, we filed yesterday request for extension time to May 15th. Am hopeful will be granted and will advise you promptly. Glad you are preparing necessary working schedules and tentative declared value excess profits tax returns and expect forward latter part

this week. Our understanding regarding consents not in accord with yours. See Paragraph eye, Page Two, of instructions for Form 1120, which in our opinion requires such consents. This has been confirmed with Revenue Agent* here who states forms of consents have been printed and are available for 1942 returns. Procedure same as last year.

M. J. CURRY.

*Mr. Scanlon Ext 252

[Initialed]: MCV ok MJC

[Stamped]: M.J.C Mar. 3, 1943.

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 7

March 15, 1943.

Collector of Internal Revenue,
Second District of New York,
Custom House,
New York, N. Y.

Dear Sir:

Enclosed herewith is Tentative Consolidated Income and Declared Value Excess-Profits Tax Return (Form 1120) of The Western Pacific Railroad Corporation for the year ended December 31st, 1942.

The estimated tax on this return is \$4,209,948. and we hand you herewith New York draft No. MT 56492 in favor of United States Collector of

Western Pacific R.R. Company, etc. 1883

Internal Revenue, New York, in the amount of \$1,052,487. covering first installment of one-fourth of the estimated tax.

Yours very truly,

/s/ M. J. CURRY,
Treasurer.

Enclosures

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 8

The Western Pacific Railroad Company

Western Union
Telegram Form

New York, May 7, 1943.

D. C. DeGraff

Western Pacific Railroad Company

526 Mission Street

San Francisco, Calif.

Reference question income and excess profits tax returns 1942: Tax lawyers have decided we should file consolidated returns, which will do on or before May 15th. Would appreciate if you will have final declared value returns prepared and executed for all subsidiaries similar to tentative returns filed in March and forward here original and two copies each. Figures on tentative returns should be corrected as follows: Show Sacramento Northern in-

1884 *Western Pacific R.R. Corp., et al., vs.*

terest \$1313.00; Net operating loss deduction \$710,-
783.55 making deficit \$391,755.08. Standard Realty
Net Operating Loss Deduction \$4407.51; Deficit
\$3,908.20.

M. J. CURRY.

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 9

The Western Pacific Railroad Company
37 Wall Street
New York

May 21, 1943.

Mr. F. C. Nicodemus
40 Wall Street
New York, N. Y.

Dear Mr. Nicodemus:

Enclosed is copy of Mr. Polk's letter of May 20,
1943, in re. tax matters. Very interesting!

I suggest it might be well for you to drop over
Monday morning, the 24th, and discuss with Mr.
Schumacher, who will leave that afternoon for
San Francisco.

Yours very truly.

/s/ M. J. CURRY.

Defendants' Exhibit No. 9—(Continued)

Copy

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

May 20, 1943.

Mr. M. J. Curry,
Vice President,
Western Pacific Railroad Company
37 Wall Street,
New York, N. Y.

Dear Mr. Curry:

On May 15, there were filed at the Office of the Collector of Internal Revenue, Custom House, New York, the Federal income, excess profits tax and declared value excess profits tax returns for the Western Pacific Railroad Company and its affiliated corporations. The items entering into the preparation of these returns were reviewed by us and on the basis of the information available, it is believed that the returns as filed met all of the conditions of the Internal Revenue Code and Bureau regulations in respect of the substantive matter contained therein and of supporting schedules.

It is believed, however, that a considerable amount of supporting detail and underlying data must be prepared in order that the figures set forth in the return can be supported upon subsequent Bureau audit. While it is true that much of this underlying detail will relate to the earnings

Defendants' Exhibit No. 9—(Continued)

and profits determination which, in turn, will probably have little effect upon invested capital, it is believed, however, desirable that the research be carried through in order that the position we assert in the returns may be hedged against the adverse implications of possible distributions out of capital which may have occurred up to the date of the last dividend payment in 1927. Further, we have used in the returns, book costs as bases for the affiliated corporation's stock investments which again may require adjustments, possible of determination only after such analyses.

It is also believed desirable to have a more complete review made of the computation of the unused excess profits credit adjustment. In the return as filed, it was assumed that the invested capital base for the years 1940 and 1941 was substantially the same as for the taxable year 1942. Undoubtedly, changes will be indicated when the schedules for borrowed invested capital and inadmissible adjustments for 1940 and 1941 have been prepared in detail. This adjustment will, in all probability, have no effect upon the 1942 tax return but will afford a more proper basis for administrative consideration of tax matters for 1943 and subsequent years.

It is further noted that a historical development of the profit and loss accounts of the several companies, not only as disclosed in their books, but as set forth in the reconciliations reported in prior Federal income tax returns, will bring to light any

Defendants' Exhibit No. 9—(Continued)

instances of write-ups, write-downs, etc. The survey of this character will also serve to establish more definite amounts of net operating loss deductions and carry overs.

Both in connection with the review of the deductions claimed for depreciation and the amounts shown for fixed capital investment returns, it will be helpful to review the significant tax positions adopted by the company and accepted by the Bureau of Internal Revenue in connection with the audits by the Bureau of Internal Revenue of prior year income tax returns. While not estopped by prior considerations and decisions, the Bureau may be disinclined to depart from previous determinations of basis of fixed capital investments as shown by treatment in computing depreciation deductions and in computing gains and losses upon the disposition of assets.

It may also be noted that it is clearly demonstrable that the consolidated return basis of reporting for the year 1942 as contrasted with a separate basis of reporting, was advantageous to the group. Since consolidated returns were filed for 1940 and 1941, any unused excess profits credit inhered in the common parent corporation, had separate returns been filed for 1942. A preliminary survey of the smaller affiliates indicates that they would have incurred no excess profits tax liability. The operating company, however, if placed on a separate basis without the benefit of the credit carryovers, would

Defendants' Exhibit No. 9—(Continued)

have been liable for a net excess profits tax liability of \$3,650,000 even if all other figures as shown in the return were left unchanged. This amount is offset by several factors. In the first place, on an individual basis, the operating companies' interest on expense deductions would have increased \$703,000. It would have lost, however, its allocable share of the net operating loss reduction of approximately \$438,000. Further, a portion of its earnings subject to excess profits tax rates would have been eliminated from normal tax rates. There would have been in addition, a reduction in the surtax rate on a separate basis of the 2% penalty for filing a consolidated return, which would have amounted to approximately \$200,000 in tax. All of these factors combine to establish a net tax advantage of in excess of \$1,550,000 in the adoption of the consolidated return under the separate return.

There is a further possibility of adjustment under the Internal Revenue Code provisions contained in Sections 23 (g) (4) and (k) (5) by which the worthlessness of the operating company's stock may produce a net loss for the year 1943 with possible carryback application. This is commented upon rather than suggested as of certain value, since it is paradoxical to compute a loss upon the operating company's stock which, through the mechanics of consolidated return reporting, could be used to nullify the very income of the affiliate whose stock

Defendants' Exhibit No. 9—(Continued)

had become worthless. This matter will receive more careful consideration when the completion of the reorganization makes possible the assertion of the claim for worthlessness of the operating company's stock.

Apart from the 1942 tax liability, we are informed that a request has been addressed to the company for the submission of basic data to be considered by the Bureau of Internal Revenue in connection with the application made under date of March 29, 1943 for permission to change the method of accounting from retirement to a depreciation basis for Federal income tax purposes. Under general procedures adopted in the Bureau, the permission to change the basis of accounting is premised upon the agreement of the applicant to adoption of accumulated depreciation reserve balances which, at the election of the company, may be determined by any one of the following methods:

1. The accounts may be reconstructed from their beginning, or may start with the I.C.C. valuation, setting up as a reserve the difference between cost of reproduction new and cost of reproduction less accrued depreciation as determined at the valuation date. From either starting point, the capital accounts shall be carried forward, increased by additions and decreased by retirements, except that any increase in replacement costs, or additions or betterments expensed, which have been deducted for income tax purposes, may not be restored. Deprecia-

Defendants' Exhibit No. 9—(Continued)

tion at rates to be agreed upon shall be computed for all years and accrued into a depreciation reserve. From this reserve shall be deducted the cost of normal retirements, but for retirements due to casualty or special obsolescence, which would have been allowable under depreciation accounting, only the accrued depreciation thereon shall be deducted.

2. A reserve may be set up by multiplying the expired life of individual structures, or the weighted average ages of the accounts representing groups of assets, now in service, by the depreciation rates agreed upon for these assets.

3. A reserve of 30% of the total depreciable accounts at the date of change may be set up. It is to be understood that this is an overall reserve and the total amount so computed is to be allocated to the different depreciable accounts on a reasonable basis, such allocation to be a matter of agreement between each railroad and the Bureau.

We are familiar with the requirements of the Bureau of Internal Revenue in connection with depreciation computations generally embodied in the Valuation Division questionnaire, the provisions of T.D. 4422 and related Bureau rulings, and have discussed the railroad situation with the Bureau of Internal Revenue officials to whom these matters are assigned. It will, undoubtedly, be necessary to complete preliminary computations under the elective methods prescribed, and to compare the possible annual benefits of depreciated accounting with the

Defendants' Exhibit No. 9—(Continued)

retirement basis heretofore followed, before administrative action can be taken to complete the application for permission to change accounting basis filed with the Bureau of Internal Revenue.

We will be glad to confer with your company officials in planning these preliminary surveys so, if possible, to minimize the work required and will be glad to make available to you the benefit of our experience in the assembly and presentation of data to the Bureau of Internal Revenue, if you elect to take advantage of the depreciation basis of tax accounting for 1943.

Very truly yours,

/s/ JAMES K. POLK.

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 10

March 9, 1944.

Mr. F. C. Nicodemus, Jr.

40 Wall St.

New York 5, N. Y.

Dear Mr. Nicodemus:

The attached copy of letter dated Feb. 4, 1944, from the office of the Attorney General, State of Delaware, is self-explanatory.

The 1941 Franchise tax which you will recall was reduced by the State Tax Board early last year as

a result of negotiations, will amount to \$1350.90 (\$1262.50 principal and \$88.40 penalty interest) on April 1, 1944. Payment should be made on or before that date if forfeiture of the Corporation's charter is to be avoided.

In view of conditions confronting the Corporation, filing of consolidated Federal income and excess profits tax returns, etc., I should like to have your advice as to whether payment of the 1941 tax should be made on or before April 1st.

Yours very truly,

/s/ M. J. CURRY.

[Marginal Note]: Mr. Campbell discussed this with Me and agreed we should request extension to July 1, 1944.

/s/ MJS

[Endorsed]: Filed Feb. 8, 1949.

DEFENDANTS' EXHIBIT No. 11

The Western Pacific Railroad Company
37 Wall Street
New York

April 1, 1943.

Via air mail

Mr. Sidney M. Ehrman,
Nevada Bank Building,
San Francisco, Calif.

Dear Mr. Ehrman:

Referring to our telephone conversation last evening:

This morning I have looked up our records to see just what the expense of making up the consolidated tax returns in our office and the tax savings effected has been since The Western Pacific Railroad Company went into trusteeship.

First of all, the certified public accountants, Lybrand, Ross Bros. & Montgomery, were employed by the "Corporation" from year to year to audit the accounts pursuant to provisions of the Securities and Exchange Act. Their charge for this audit has averaged approximately \$1,000 a year. For the past two years we have consulted them on excess profits tax on a consolidated basis and their charge for this was \$150 in 1940 and \$400 in 1941, which was paid by the Corporation.

This work has all been done in this office and consolidated tax returns have been prepared and filed under Mr. Curry's supervision. I might add

that during the years the Company has been in trusteeship, payment of income taxes for the consolidated group was nil because of the large consolidated deficits. In fact, the Tidewater Southern, which made a profit every year and was included in the returns, benefited by these deficits which effected a tax saving to it of approximately \$116,000 for the six year period. During that period expert advice from counsel was not necessary.

However, commencing with 1942, the situation has changed considerably because the affiliated companies' earnings have greatly increased. For this reason and in view of the new complicated tax law, we now require the advice of competent tax attorneys.

For your further information, I find that the last payment of consolidated income tax was made in 1929. At that time there was a net consolidated taxable income of \$365,000, on which the income tax amounted to \$40,230.

Yours very truly,

/s/ T. M. SCHUMACHER.

cc. Mr. Charles Elsey
Mr. Allan Matthew
Mr. F. C. Nicodemus, Jr.

[Endorsed]: Filed Feb. 10, 1949.

DEFENDANTS' EXHIBIT No 12

Filed March 3, 1944,
C. W. Calbreath, Clerk.

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California

In the District Court of the United States, for the
Northern District of California, Southern Di-
vision.

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD
COMPANY,

Debtor.

ORDER AUTHORIZING ESTABLISHMENT
OF A RESERVE FUND FOR CONTIN-
GENT TAX LIABILITIES

The petition filed February 21, 1944, by T. M. Schumacher and Sidney M. Ehrman, the Trustees of the properties of the Debtor above named, for authority to establish a reserve fund of \$7,100,000 for contingent tax liabilities, came on duly to be heard and was heard this day and thereupon submitted. Good cause appearing therefor, the Court, being fully advised, finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court, that all of the averments of said petition are true, and that it is for the best interests of the estate of the Debtor that this order be made.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed that the Trustees are hereby authorized to establish, with funds in their hands belonging to the estate of the Debtor and derived from the earnings of the railroad of the Debtor during the year 1943, a reserve fund in the amount of \$7,100,000, to be designated as the "Reserve Fund for Contingent Tax Liabilities," to be invested in United States Treasury securities, and to be used for the payment of any Federal income and excess profits taxes which may be found due for the year 1943.

Dated: March 3, 1944.

A. F. ST. SURE,
Judge.

[Endorsed]: Filed Feb. 10, 1949.

Western Pacific R.R. Company, etc. 1897

DEFENDANTS' EXHIBIT No. 13

The Western Pacific Railroad Corporation
Office of the President
37 Wall Street

New York 5.
May 19, 1944.

Mr. James K. Polk
Whitman, Ransom, Coulson & Goetz
40 Wall Street
New York, 5, N. Y.

Dear Mr. Polk:

I will appreciate advice from you as to nature of
reply to be made to letter from Robert L. Whittaker
& Co., Philadelphia, of which enclosed is a copy.

Yours very truly,

/s/ M. J. CURRY

cc. Mr. F. C. Nicodemus, Jr.

1898 *Western Pacific R.R. Corp., et al., vs.*

(Copy)

Robert L. Whittaker & Co.

1420 Walnut Street

Philadelphia

May 17, 1944.

Western Pacific Railroad Corporation

37 Wall Street

New York, N. Y.

Gentlemen:

It has occurred to us as holder of Western Pacific 5s due 1946 that the large tax credit in the earnings statement for December 1943 of the Western Pacific could take place annually for some years to come, as long as the Revenue Act allows holding companies to consolidate their returns of subsidiaries for income tax purposes.

Since the ownership of the Western Pacific Railroad was declared valueless for 1943 we thought possibly this loss, which must involve upwards of \$50,000,000, could be used as a tax credit for future years until the total loss is used.

We would appreciate hearing from you regarding this situation.

Very truly yours,

/s/ ROBERT L. WHITTAKER
& CO.

RLW :es

[Endorsed]: Filed Feb. 10, 1949.

DEFENDANTS' EXHIBIT No. 14

September 12, 1944

Mr. Sidney M. Ehrman
Nevada Bank Building
San Francisco 4, California

My dear Mr. Ehrman:

From your letter to Mr. Schumacher which he was good enough to show me it seems evident that there is a lack of understanding in San Francisco of the nature and extent of the services rendered and being rendered by our firm as counsel for The Western Pacific Railroad Company.

These services are under employment by the Railroad Company continued by the Trustees.

They may be roughly placed in four general categories which I shall set out below in which seems to me to be the order of their importance.

First: Services rendered as counsel here for Mr. Schumacher, Trustee resident in New York, in respect of all matters of administration and operation with which he is specifically charged and as to which he requires day to day advice. These include his relations with the Association of American Railroads and with governmental authorities at Washington; negotiating, closing and renewing loans; attendance at meetings of member roads; and generally all matters for which he is jointly responsible as Trustee and wishes to consult and exchange views with counsel on the ground. My understanding is that he explained to Judge St. Sure at the outset

Defendants' Exhibit No. 14—(Continued)

the necessity of having such counsel and that Judge St. Sure acquiesced.

Second: Services rendered by New York counsel as a member of the Law Committee of the Association of American Railroads. The Law Committee is composed of selected counsel for the principal carriers and I have been a member for many years. Meetings are held alternately at New York and Chicago and ordinarily continue for two days. The docket rarely has less than twenty items, each of which is a problem of major importance to the railway industry. Through this source and through my membership in the Railway Conference which meets weekly in New York I have been in a position to keep Mr. Schumacher informed and keep myself informed as to what is going on in the railway industry that may affect our property. It would serve no useful purpose to review these various problems. They include, however, such matters as the dismemberment of the Pullman Company; the land grant problem; and the recent anti-trust suit in which you and Mr. Schumacher are named as defendants.

Third: Services rendered in the matter of Federal taxation. All tax returns for the Railroad Company and for the Trustees have been made from New York under advice of New York counsel. Owing to the heavily increased tax burden incident to the war economy, the complex Federal tax structure and the necessity of recurring conferences with the Commissioner of Internal Revenue and the

Defendants' Exhibit No. 14—(Continued)

Treasury, the firm of Whitman, Ransom, Coulson & Goetz on our advice were brought in a year or more ago as tax consultants. They are peculiarly well equipped to serve in that capacity. The responsibility of New York counsel for the Railroad Company has not, however, been limited to work under the existing tax laws but has required constant attention to proposed changes that might adversely affect our property. In the last Congress the so-called Johnson Bill was originally so drawn that it would deprive the Western Pacific of the invaluable carry-over and carry-back provisions of the present Act. Our firm prepared and submitted amendments to protect the situation which Senator Johnson accepted. At the present time legislation is in process of incubation which unless the interests of the Western Pacific are guarded may prove equally embarrassing.

Fourth: Services rendered currently on routine matters. Included in this category are (a) attention to litigation in New York on loss and damage claims in which the Western Pacific is a participating carrier; (b) the corporate work for subsidiaries; (c) problems arising under our commitments to the New York Stock Exchange; (d) reports to governmental authorities; (e) problems under corporate mortgages; (f) correspondence with security holders in relation to their personal tax problems; and (g) a variety of matters of minor importance too numerous to classify but nevertheless being often tedious and exacting.

Defendants' Exhibit No. 14—(Continued)

It is my best judgment that the allowance we are receiving currently from the trust estate is not even compensatory for the services rendered in the last category.

The question is not whether any part of our current allowance should be applied toward compensation as counsel for the Debtor in the reorganization proceedings—this would be inadmissible under the terms of the order of Court—but the real question is whether our firm should not in justice to ourselves apply at some future time for compensation for the services falling in categories First, Second and Third. As matters now stand these services have been rendered gratuitously.

It is less important, however, that our firm be justly compensated than it is that you and perhaps Judge St. Sure should have a broader understanding of what has been and is being done here in the interest of the Western Pacific property.

As Mr. Schumacher has advised you it is my purpose to attend the hearing which is set for September 25th. I cannot leave here earlier than September 21st but unless the Overland is late I expect to be on hand at the opening of the Court.

My best regards to you.

Yours very truly,

F. C. NICODEMUS, JR.

[Endorsed]: Filed Feb. 10, 1949.

DEFENDANTS' EXHIBIT No. 15

Heller, Ehrman, White & McAuliffe

Attorneys and Counselors at Law

Nevada Bank Building

San Francisco

(4)

September 14, 1944

Mr. F. C. Nicodemus, Jr.

Messrs. Pierce & Greer

40 Wall Street

New York 5, N. Y.

My dear Mr. Nicodemus:

I am in receipt of your letter of September 12th going into some detail in regard to the nature and extent of the services which are being rendered by you on behalf of The Western Pacific Railroad Company and its trustees. I wrote to Mr. Schumacher after you had filed your petition so that if both of us are called by the judge during the hearing on the subject of your compensation our testimony would be in harmony.

I have always been under the impression that the monthly compensation paid to your firm is the only compensation for which the trustees or the trust estate have incurred any liability. Your representation of the debtor company in the reorganization proceeding is, as I view it, a separate matter with which we as trustees are not concerned.

With kind regards,

Very truly yours,

/s/ SIDNEY M. EHRMAN

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANTS' EXHIBIT No. 17
(Identification only)

Henry Offerman

Schedule of Preferred Stock of Western Pacific Railroad Corporation Owned as at April 1, 1948, Showing Date of Purchase and Cost of Each Certificate

Certificates Held				Purchase Confirmations			No. of Shares	
Date	Cert. No.	No. Shares	Name	Trade Date Bought	Price Per Share	Total Cost (Including Commissions)	Broker	Total on Confirmation
7/14/42	D20730	100	Henry Offerman	7/ 7/42	5/8	66.50	Goodbody & Co.	100
8/26/42	D20764	100	Henry Offerman	8/13/42	5/8	66.50	Goodbody & Co.	100
2/ 8/43	D21282	100	Cohen, Simonson & Co.).....	(5/ 6/43	1/2	57.00	R. F. Gladwin & Co.	100)
2/ 8/43	D21281	100	Cohen, Simonson & Co.).....	(5/ 6/43	1/2	52.00	R. F. Gladwin & Co.	100)
4/19/43	D22282	100	Ruth Haiken).....					
4/19/43	D22283	100	Ruth Haiken).....					
4/19/43	D22284	100	Ruth Haiken).....	7/ 6/43	3/8	228.75	R. F. Gladwin & Co.	500)
4/19/43	D22286	100	Ruth Haiken).....					
4/19/43	D22287	100	Ruth Haiken).....					1,000
4/26/43	D22342	100	Maude Remsberg	7/ 6/43	1/4	39.50	R. F. Gladwin & Co.	100)
3/25/43	D21834	100	Thomson & McKinnon	8/31/43	1/8	14.00	R. F. Gladwin & Co.	100
3/25/43	D21881	100	Mansell & Co.....	9/20/43	1/8	19.00	R. F. Gladwin & Co.	100
3/29/43	D21996	100	Thomson & McKinnon	11/ 5/43	1/8	13.50	Goodbody & Co.	100
3/29/43	D22000	100	Thomson & McKinnon	11/10/43	1/8	13.50	Goodbody & Co.	100
3/ 1/44	D22456	100	Henry Offerman).....					400
3/ 1/44	D22457	100	Henry Offerman).....					
3/ 1/44	D22458	100	Henry Offerman).....	1/14/44	15c	32.00	R. F. Gladwin & Co.	200
3/ 1/44	D22459	100	Henry Offerman).....	2/ 2/44	1/4	34.25	R. F. Gladwin & Co.	103
3/ 1/44	D22460	100	Henry Offerman).....	2/ 3/44	1/4	66.50	R. F. Gladwin & Co.	200
3/ 1/44	D22461	100	Henry Offerman).....	2/ 4/44	1/4	116.00	R. F. Gladwin & Co.	400
3/ 1/44	D22462	100	Henry Offerman).....	2/ 5/44	1/4	88.50	R. F. Gladwin & Co.	300
3/ 1/44	D22463	100	Henry Offerman).....					
3/ 1/44	D22464	100	Henry Offerman).....					
3/ 1/44	D22465	100	Henry Offerman).....					
3/ 1/44	D22466	100	Henry Offerman).....					
3/ 1/44	D22467	100	Henry Offerman).....					
3/ 1/44	D042746	3	Henry Offerman).....					
3/ 9/44	D22610	100	Henry Offerman).....					
3/ 9/44	D22611	100	Henry Offerman).....					
3/ 9/44	D22612	100	Henry Offerman).....	2/29/44	1/2	216.00	Goodbody & Co.	400
3/ 9/44	D22613	100	Henry Offerman).....	3/ 1/44	1/2	54.00	Goodbody & Co.	100
3/ 9/44	D22614	100	Henry Offerman).....	3/ 1/44	1/2	54.00	Goodbody & Co.	100
3/ 9/44	D22615	100	Henry Offerman).....					
3/14/44	D22630	100	Henry Offerman).....					
3/14/44	D22631	100	Henry Offerman).....					
3/14/44	D22632	100	Henry Offerman).....	3/ 7/44	3/8	250.00	Kearns & Williams	500
3/14/44	D22633	100	Henry Offerman).....					700
3/14/44	D22634	100	Henry Offerman).....					
4/25/44	D22825	100	Henry Offerman).....	4/14/44	5/8	158.00	J. S. Farlee & Co., Inc.	200
4/25/44	D22826	100	Henry Offerman).....					200
Totals.....						<u>1,639.50</u>		<u>3,903</u>
								<u>6,303</u>

(Identification only)

Henry Offerman

Summary Schedule of All Purchases and Sales of Western Pacific Railroad Corporation Preferred Stock

Trade Date	Broker	Purchases			Sales		
		No. of Shares	Price Per Share	Total Cost	No. of Shares	Price Per Share	Total Proceeds
7/ 7/42	Goodbody & Co.	100	5/8	\$ 66.50			
8/13/42	Goodbody & Co.	100	5/8	66.50			
5/ 6/43	Gladwin & Co.	400	1 1/2 +)	525.00			
		400	3/8 +)				
5/ 7/43	Gladwin & Co.	200	3/8 +	91.50			
7/ 6/43	Gladwin & Co.	500	1/4 +)	426.25			
		500	3/8 +)				
8/31/43	Gladwin & Co.	1000	1/8	140.00			
9/20/43	Gladwin & Co.	100	1/8	19.00			
11/ 5/43	Goodbody & Co.	100	1/8	13.50			
11/10/43	Goodbody & Co.	400	1/8	54.00			
1/14/44	Gladwin & Co.	200	16c	32.00			
2/ 2/44	Gladwin & Co.	103	1/4 +	34.25			

1906

Western Pacific R.R. Corp., et al., vs.

Trade Date	Broker	Purchases			Sales		
		No. of Shares	Price Per Share	Total Cost	No. of Shares	Price Per Share	Total Proceeds
2/ 3/44	Gladwin & Co.	200	1/4 +	66.50			
2/ 4/44	Gladwin & Co.	400	1/4 +	116.00			
2/ 5/44	Gladwin & Co.	300	1/4 +	88.50			
2/29/44	Goodbody & Co.	400	1/2	216.00			
3/ 1/44	Goodbody & Co.	100	1/2	54.00			
3/ 1/44	Goodbody & Co.	100	1/2	54.00			
3/ 7/44	Kearns & Williams	700	3/8 +	350.00			
3/18/44	Goodbody & Co.	100	5/8	66.50			
4/ 8/44	Goodbody & Co.				200	7/8	\$ 151.00
4/14/44	J. S. Farlee & Co.	200	5/8 +	158.00			
7/12/44	Gladwin & Co.				1400	7/8	1,064.00
3/26/45	Gladwin & Co.	300	1/2	156.75			
5/12/45	Goodbody & Co.				400	1 +	344.00
11/23/45	Goodbody & Co.				500	1 1/8	502.50
2/19/46	Goodbody & Co.				500	1 3/8	627.50
Totals.....		6903		\$2,794.75	3000		\$2,689.00

DEFENDANTS' EXHIBIT No. 19

(Identification only)

Cleta C. Offerman

Schedule of All Purchases and Sales of Western Pacific Railroad Corporation Preferred Stock

Date	Broker	Purchases			Sales		
		No. of Shares	Price Per Share	Total Cost	No. of Shares	Price Per Share	Total Proceeds
4/29/43	Goodbody & Co.	100	$\frac{7}{8}$	\$ 91.50			
4/30/43	Goodbody & Co.	900	$\frac{7}{8}$	823.50			
7/14/43	Goodbody & Co.	400	$5/16$	133.00			
4/22/44	Goodbody & Co.	400	$5/8$	266.00			
7/12/44	R. F. Gladwin & Co.				1600	$\frac{7}{8}$	\$1,216.00
2/18/46	Goodbody & Co.				200	$11/8$	201.00
					1800		\$1,417.00
	Totals.....	1800		\$1,314.00			

DEFENDANTS' EXHIBIT No. 20

Order No. 1

Entered 193

In the District Court of the United States for
the Northern District of California, Southern
Division

In proceedings for the reorganization of a
railroad. No. 1

In the Matter of

THE WESTERN PACIFIC RAILROAD
COMPANY,

Debtor.

ORDER

Upon due consideration of the petition of The Western Pacific Railroad Company, the above named debtor, verified August 2, 1935, and filed herein this day, stating that such debtor is unable to meets its debts as they mature and that it desires to effect a Plan of Reorganization in accordance with Section 77 of Chapter VIII of the Acts of Congress relating to bankruptcy, and the Court being satisfied that such petition complies with said section and has been filed in good faith, it is ordered:

(1) That said petition be, and hereby is, approved as properly filed under Section 77 of Chapter VIII of the Acts of Congress relating to bankruptcy.

(2) That the debtor be, and it hereby is, authorized and directed, pending further order of the court

Defendants' Exhibit No. 20—(Continued)

in the premises, to run, manage, maintain, operate and keep in proper condition and repair the railroads and property of the debtor, wherever situated, whether in this state, judicial circuit, or elsewhere and to manage and conduct its business as a railroad company, and to this end to exercise its authority and franchises and discharge all public duties obligatory upon it, and to employ and discharge and fix the compensation of all officers, attorneys, managers, superintendents, agents and employees; to collect and receive the incomes, rents, revenues, tolls, issues and profits of said property; to collect all outstanding accounts and all dividends and interest on securities belonging to it; to exercise such sale, conveyance, exchange and release rights as are reserved to, or available to, the debtor, under outstanding deeds of trust, mortgages, trust indentures and similar instruments, and to use the proceeds of sale of all released property as provided in such instruments; all in the same manner that it would be entitled and bound to do in its own right; and, to the extent necessary to protect and preserve the property of the debtor, to make and pay for additions and betterments to the railroads and property of the debtor; and to make such advances to its subsidiary corporations as are necessary to protect the debtor's interest therein, all in the same manner that it would be entitled and bound to do in its own right; and, to the extent necessary to protect and preserve the property of the debtor, to make and pay for

Defendants' Exhibit No. 20—(Continued)

ments with transit or storage privileges and other charges or adjustments of like character, between carriers in the conduct of their joint business, regardless of when accrued.

(d) Pending further order of this Court in the premises, the debtor hereby is authorized to pay pay checks, and like instruments issued to employees for services rendered to the debtor, whether before or during said six months' period, whenever the same are presented for payment.

(e) The cost of maintaining the corporate existence of the debtor, including the necessary expenses of the preservation of records, and the registration and transfer of its stocks and bonds, and trustees' charges under indenture under which securities of the debtor have been issued.

(f) All monthly payments due from time to time under any existing pension or insurance system of the debtor.

(g) The expense of printing pleadings, motions, petitions and orders now on file or hereafter filed in this case reasonably necessary to be printed, in such quality as shall provide copies for the use of the Court, the debtor, parties to the cause, and such others as may have a substantial interest therein; such expense to be taxed as costs in this case.

(4) That the debtor shall be allowed until January 1, 1936 (unless the time be extended further by order of this Court), within which to disaffirm any contracts. Such disaffirmance shall be indicated by

Defendants' Exhibit No. 20—(Continued)

notice to that effect, in writing, served on the other party or parties to such contract, and filed of record in this proceeding, and continued operation by the debtor under any of said contracts, within said period allowed for disaffirmances, shall not be deemed to conclude the debtor in respect of such election, or to constitute an election.

(5) That, pending further order of the Court in the premises, the debtor is authorized and empowered to institute or prosecute in any Court, or before any tribunal of competent jurisdiction, all such suits and proceedings as may be necessary, in its judgment, for the recovery or proper protection of its property or rights, and to make settlement of any thereof; and likewise to defend or liquidate, by written agreement or consent judgments, any actions, claims, proceedings, or suits, now pending against the debtor, or which may hereafter be asserted, or be brought in any Court, or before any officer, department, commission or tribunal, to which the debtor is, or shall be, a party, but no payments shall be made by the debtor in respect of any such claims accruing prior to the date of this order, in respect of any actions, proceedings, or suits, on such claims, without further order or direction of this Court except as may be provided in other paragraphs of this order and except such as may be permitted by other general orders hereafter entered herein, and such as constitute preferred claims under the Acts of Congress relating to bankruptcy; and no

Defendants' Exhibit No. 20—(Continued)
this order as to the Court may at any time seem
proper.

A. F. ST. SURE,
District Judge

Dated August 2, 1935.

Filed

[Endorsed] Filed Feb. 11, 1949.

DEFENDANTS' EXHIBIT No. 21

Warren Olney, Jr.,
Balfour Building,
San Francisco, California.

Pierce & Greer,
15 Broad Street,
New York City,
New York.

In the District Court of the United States for
the Northern District of California, Southern
Division

No. 26591-S

In the Matter of
THE WESTERN PACIFIC RAILROAD
COMPANY,

Debtor.

ORDER APPOINTING TRUSTEES

This cause coming on further to be heard this day
pursuant to subdivision (c) of amendatory Section

Defendants' Exhibit No. 21—(Continued)

77 of Chapter VIII of the Acts of Congress relating to bankruptcy and to the Order of this Court entered herein August 31, 1935;

And it appearing to the Court that debtor has given notice as directed in said Order entered August 31, 1935, to the mortgage trustees, creditors and stockholders and has caused publication thereof for such period and in such newspapers as said Order directs of a hearing to be held this day at ten o'clock in the forenoon, at which hearing, or any adjournment thereof, the Court shall appoint one or more trustees of debtor's property, as provided in said amendatory Section 77; and the following parties having appeared herein, or communicated to this Court recommendations with respect to the appointment of such trustees:

Crocker First National Bank of San Francisco and Samuel Armstrong, successor trustees, under indenture securing debtor's First Mortgage 5% Bonds;

The Chase National Bank of the City of New York, as trustee under indenture securing debtor's General and Refunding Mortgage Bonds;

A. C. James Co., holder of certain of debtor's secured promissory notes;

Reconstruction Finance Corporation, holder of certain of debtor's secured promissory notes;

The Railroad Credit Corporation, holder of certain of debtor's secured promissory notes;

Fidelity-Philadelphia Trust Co, Trustee, of equipment obligations to Baldwin Locomotive Works;

Defendants' Exhibit No. 21—(Continued)

The Chase National Bank of the City of New York, as Trustee under agreement dated March 1, 1923, covering Equipment Trust Certificates;

The Chase National Bank of the City of New York, as Trustee under agreement dated March 15, 1924, covering Equipment Trust Certificates;

The Chase National Bank of the City of New York, as Trustee under agreement dated May 1, 1929, covering Equipment Trust Certificates;

The Western Pacific Railroad Corporation, holder of debtor's obligation for advances on open account;

The Western Realty Company, holder of debtor's obligation for advances made on open account;

The Western Pacific Railroad Corporation, holder of debtor's Preferred Capital Stock;

The Western Pacific Railroad Corporation, holder of debtor's common stock;

And it appearing to the Court that the creditors and stockholders of the debtor represent that the appointment of trustees herein should not disturb the continuity of operations by the corporate organization of the debtor and should be at minimum cost to the debtor;

And it further appearing to the Court that under the by-laws of the debtor, T. M. Schumacher, as Chairman of the Executive Committee, is invested with general charge and supervision of and over the affairs and business of the debtor, and, subject to the control of the Board of Directors and Executive Committee, is given general supervision and direc-

Defendants' Exhibit No. 21—(Continued)

tion of the debtor's business in all its departments and over all its officers, agents and employes;

And it further appearing to the Court that Charles Elsey, President of the debtor, is its chief operating officer, directing all of its operations as a common carrier, subject only to the supervision and direction of the Chairman of the Executive Committee;

And it further appearing to the Court that the Chairman of the Executive Committee has conducted all negotiations as to the formulation of pending form of reorganization of the debtor with representatives of holders of the First Mortgage Bonds and its junior creditors, all of whom are in the East, including Reconstruction Finance Corporation, which is undertaking to provide up to ten million dollars of new money to be expended in improving the property of the debtor and for working capital;

And it further appearing that Messrs T. M. Schumacher and Charles Elsey, if appointed trustees of the debtor, to serve with the additional trustee hereinafter mentioned; are willing to serve without compensation other than that which they are now receiving as such executive officers, and to perform all of their duties pertaining to such officers, so that the appointment of the trustees herein will be without cost to the estate of the debtor, except the salary or compensation of the additional trustee hereinafter mentioned;

Defendants' Exhibit No. 21—(Continued)

And it further appearing to the Court that under the provisions of subdivision (c) of said amendatory Section 77, it is necessary for the Court to appoint an additional trustee, who within one year prior hereto has not been an officer, director or employe of the debtor, any subsidiary corporation or any holding company connected therewith;

It Is Hereby Ordered:

1. That T. M. Schumacher, Chairman of the Executive Committee of the debtor; Charles Elsey, President of the Debtor; and Sidney M. Ehrman, who within one year prior to the date of this Order has not been an officer, director or employe of the debtor, any subsidiary corporation or any holding company connected therewith, be and they hereby are appointed trustees of the debtor's property, which appointments, as well as the other provisions of this Order, shall be effective as of the beginning of business on October 1, 1935, upon ratification thereof by the Interstate Commerce Commission, as provided in subdivision (c) of said amendatory Section 77.

2. That said trustees shall have all the title and shall exercise, subject to the control of this Court and consistent with the provisions of said amendatory Section 77, all of the powers of trustees appointed pursuant to Section 44 of said Act; and, to the extent not inconsistent with said amendatory Section 77, the powers of a receiver in equity pro-

Defendants' Exhibit No. 21—(Continued)

ceeding; and, subject to the control of this Court and the jurisdiction of the Interstate Commerce Commission, as provided by the Interstate Commerce Act as now or hereafter amended, the power to operate the business of the debtor, which business shall be conducted in the name of the debtor by its regularly elected or appointed corporate officers, agents and employes, but under and subject to the direction of said trustees.

3. That said trustees shall have all of the powers, rights, privileges, duties and obligations heretofore granted to or imposed upon the debtor pursuant to the Order of this Court entered herein August 2, 1935, and any and all orders supplementary thereto or amendatory thereof; and each and all of the orders heretofore entered in this proceeding shall, with respect to the said trustees and the property of the debtor, be of like force and effect as though said trustees were therein specifically named in the place of the debtor, all of said orders being hereby incorporated in and made a part of this Order by reference.

4. That within five days from and after October 1, 1935, each of said trustees shall execute and file with the Clerk of this Court a bond or bonds with one or more sureties approved by the Clerk of this Court, for the benefit of whom it may concern, in the sum of Twenty-five thousand dollars, conditioned to the effect that they will well and truly perform

Defendants' Exhibit No. 21—(Continued)
the duties of their office and duly account for any moneys or properties which may come into their hands, and abide by and perform all things which they shall be directed by the Court to do.

5. That this Court reserves full right and jurisdiction to make from time to time such additional orders herein as to the Court shall seem proper, as well as any orders amplifying, extending, limiting or otherwise modifying this Order, and in all respects to regulate and control the conduct of said trustees.

Dated: September 23, 1935.

A. F. ST. SURE,
District Judge.

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANTS' EXHIBIT No. 22

In the District Court of the United States, for the
Northern District of California, Southern
Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

OPINION AND ORDER CONFIRMING THE
APPOINTMENT OF TRUSTEES AS AP-
POINTED BY THE COURT AND RATI-
FIED BY THE INTERSTATE COMMERCE
COMMISSION

The above proceeding was initiated on August 2, 1935, by the filing of a petition by the debtor representing that it was unable to meet its financial obligations as they became due and praying for the opportunity to effect a reorganization under the provisions of Section 77 of the Bankruptcy Act.

At the time the petition was filed the Bankruptcy Act made it optional with the Court either to allow the debtor to remain in possession of and to continue to operate its railroad and other properties during the pendency of the reorganization proceeding, or to appoint a trustee or trustees for that purpose.

It was represented to the Court that there was no occasion to appoint a trustee or trustees; that Mr.

Defendants' Exhibit No. 22—(Continued)

Charles Elsey, a resident of this district and who maintained his office in San Francisco, was the President of the Company and in immediate charge of the debtor's railroad and properties; that he had been in the service of the Company for many years and was thoroughly familiar with its properties and its various problems; that he managed its affairs efficiently and economically; that he had not come into the service of the Company at the instance of any particular interest, nor did he represent any particular interest; that if no trustee were appointed, he would continue as President of the Company, to manage and operate its railroad and properties; and that he could be fully relied upon to do so faithfully and efficiently and in the interest of all parties concerned without distinction between them.

The Court inquired into the representations so made and examined Mr. Elsey under oath, and came to the opinion that the representations were true, that the control, operation and management of the debtor's properties could safely be left to him as the President of the debtor, and that no useful purpose would be served by the appointment of a trustee or trustees.

Because of this conclusion, the Court in its order approving the petition of the debtor as properly filed, refrained from appointing a trustee and authorized and directed the debtor to continue in the possession and operation of its properties. At the time the Court made this order it explicitly

Defendants' Exhibit No. 22—(Continued)

informed Mr. Elsey that the properties of the debtor were now in the custody of the Court and his primary obligation was to the Court and the Court relied upon him to see to it that the properties were properly and economically managed and operated, and received from Mr. Elsey his assurance that he so understood and would govern himself accordingly. Since that time the Court has had no reason to doubt the correctness of its opinion as to the truth of the representations made to it concerning Mr. Elsey, or its confidence in the assurances given by him.

Subsequently to the order referred to, the Bankruptcy Act was amended by Congress, making it mandatory upon the Court to appoint one or more trustees, and providing that if one who was connected with the debtor were appointed, there should also be appointed one who had no such connection, such appointment to be subject to confirmation by the Interstate Commerce Commission.

Immediately upon such amendment being made, the Court proceeded, on formal hearing in the manner required by the Act, to appoint trustees for the property of this particular debtor. The Court desired that at least one trustee should be a person residing within the district, experienced in railroad management and familiar with the railroad of the particular debtor and in whom the Court had confidence. Such a person was Mr. Elsey.

The large creditors of the debtor and the controlling stockholding interest in it, requested the

Defendants' Exhibit No. 22—(Continued)

appointment of Mr. T. M. Schumacher, Chairman of the Executive Committee of the debtor, representing that he had conducted all negotiations looking to the formulation of a plan of reorganization. Mr. Schumacher has his residence and his office in New York. The Court was willing to accede to this request, provided there was also appointed as trustee one who resided and had his office in this district and could attend to the immediate management and operation of the property.

The selection of Mr. Elsey and Mr. Schumacher required the selection of a third trustee not connected with the debtor. As such trustee the Court selected Mr. Sidney M. Ehrman, a lawyer of large experience, in whose discernment, judgment and integrity it had full confidence.

For the reasons stated, the Court appointed three persons named. This appointment being made, the Interstate Commerce Commission was petitioned to ratify it. The Commission has now made its order ratifying the appointment of Mr. Schumacher and Mr. Ehrman, but declining to ratify that of Mr. Elsey.

It is evident that looking at the trustees as a unit, a board, as it were, the composition of the board without Mr. Elsey is very different from that which the Court contemplated. The Court conceives that the primary duty of the trustees is to manage and operate the railroad and other properties of the debtor while they are in the custody of the Court, and for this reason the Court desired that

Defendants' Exhibit No. 22—(Continued)

one of the trustees should be a person who could devote himself on the ground to the immediate and active management of the debtor's railroad and property. Neither Mr. Schumacher or Mr. Ehrman is in a position to do this. The Court has also some doubt as to the feasibility, or at least the efficiency, of an administration by two trustees, the concurrence of both of whom is necessary for any action taken, and one of whom resides in San Francisco and the other in New York.

The Court has the power to revoke the appointments already made and to make new appointments conforming to what it believes the necessities of the case require, such new appointments, of course, to be subject, in turn, to ratification by the Commission. That course, however, would cause considerable delay, which is to be avoided if possible, and the Court believes that the particular object it had in mind by the appointment of Mr. Elsey can be substantially accomplished by the trustees employing him as their agent to manage the railroad and properties of the debtor. The Court has consulted with Mr. Elsey, who has expressed his willingness to act in that capacity.

It Is Therefore Hereby Ordered:

1. That T. M. Schumacher and Sidney M. Ehrman be and the same are the trustees of the properties of the debtor, duly appointed by this Court and ratified by the Interstate Commerce Commission.

Defendants' Exhibit No. 22—(Continued)

2. That each of said trustees shall forthwith and within ten (10) days from the date hereof execute and file with the Clerk of this Court a bond or bonds, with one or more sureties approved by the Clerk of this Court, for the benefit of whom it may concern, in the sum of \$25,000, conditioned to the effect that he will well and truly perform the duties of his office and duly account for any moneys or properties which may come into his hands and abide by and perform all things which he shall be directed by the Court to do.

3. That said trustees be and they are hereby instructed and directed to engage Charles Elsey as their agent to operate and manage the railroad and properties of the debtor.

4. That said trustees shall have all the title and shall exercise, subject to the control of this Court and consistent with the provisions of amendatory Section 77 of Chapter VIII of the Acts of Congress relating to bankruptcy, all of the powers of trustees appointed pursuant to Section 44 of said Act; and, to the extent not inconsistent with said Section 77, the powers of a receiver in equity proceedings; and, subject to the control of this Court and the jurisdiction of the Interstate Commerce Commission as provided by the Interstate Commerce Act as it now exists or may hereafter be amended, the power to conduct the business of the

Defendants' Exhibit No. 22—(Continued)

debtor, with authority to them to conduct such business to the extent they deem advisable in the name of the debtor and by its officers, agents, and employees.

5. That said trustees shall have all of the powers, rights, privileges, duties and obligations heretofore granted to or imposed upon the debtor by the order of this Court entered herein August 2, 1935, and any and all orders supplementary thereto or amendatory thereof; and each and all of the orders heretofore entered in this proceeding shall, except so far as the same are not inconsistent with the express provisions of this order, be of like force and effect with respect to the said trustees and the property of the debtor as though said trustees were therein specifically named in the place of the debtor, all of said orders being hereby incorporated in and made a part of this order by reference.

6. That this Court reserves full right and jurisdiction to make from time to time such additional orders herein as to the Court shall seem proper, as well as any orders amplifying, extending, limiting or otherwise modifying this order, and in all respects to regulate and control the conduct of said trustees.

Dated: November 9, 1935.

A. F. ST. SURE,

United States District Judge.

[Endorsed]: Filed Feb. 11, 1949.

1930 *Western Pacific R.R. Corp., et al., vs.*

DEFENDANTS' EXHIBIT No. 23

Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York (5), N. Y.

Original Filed Dec. 17, 1943.
With Clerk, U. S. Dist. Court,
San Francisco.

In the District Court of the United States for the
Northern District of California, Southern
Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER AUTHORIZING AND DIRECTING
TRANSFER OF PREFERRED AND COM-
MON STOCK OF THE DEBTOR TO THE
REORGANIZATION COMMITTEE AND
APPROVING ACTION OF THE COMMIT-
TEE IN JOINING IN A CONTRACT FOR
SECURING CONTROL OF SUCH STOCK
AND ACTS OF THE COMMITTEE IN CON-
NECTION WITH SUCH CONTRACT

The petition filed December 1, 1943, by Frederick
H. Ecker, Frank C. Wright and Robert E. Coulson,
the Reorganization Committee designated to put
into effect and carry out the plan of reorganization

of the debtor above named, for an order authorizing and directing transfer of the preferred and common stock of the debtor to the Reorganization Committee and approving action of the Committee in joining in a contract for securing control of such stock and other acts of the Committee in connection with such contract, came on duly to be heard and was heard this day and thereupon submitted.

The Court, being fully advised, finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court dated December 1, 1943, that all of the averments of said petition are true, that the transfer and delivery by The Western Pacific Railroad Corporation of the preferred and common stock of the debtor company to the Reorganization Committee is necessary for carrying out and making effective the plan of reorganization of the debtor, and that it is for the best interests of the estate of the debtor that this order be made.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed:

1. That the Western Pacific Railroad Corporation, in order to carry out and make effective the plan of reorganization of the debtor, be and hereby is directed to assign, transfer and deliver or cause to be assigned, transferred and delivered to the Reorganization Committee or its nominee, all of the preferred and common stock of the debtor company; provided that such assignment, transfer and delivery

shall be made at the time and place fixed in a written request of the Reorganization Committee;

2. That the action of the Reorganization Committee in joining in and becoming a party to the agreement dated November 22, 1943, with The Western Pacific Railroad Corporation and its secured creditors, a copy of which was filed with the Court on December 1, 1943, be and the same hereby is in all respects approved;

3. That the Reorganization Committee is hereby authorized, in its discretion, to make written request upon The Western Pacific Railroad Corporation for the assignment, transfer and delivery of the preferred and common stock of the debtor company and for such other action by The Western Pacific Railroad Corporation as the Reorganization Committee may deem necessary or convenient for the purpose of carrying out and making effective the plan of reorganization of the debtor, and the Reorganization Committee is authorized to accept transfer of such stock for the purpose of carrying out and making effective the plan of reorganization of the debtor; and

4. That the Reorganization Committee be and hereby is authorized to file with the Interstate Commerce Commission such applications for authority or approval as may be appropriate in providing for the payment of stock transfer taxes out of the debtor's estate in respect of the transfer of the pre-

ferred and common stock of the debtor company if any such taxes shall lawfully be applicable.

Dated: December 17, 1943.

A. F. ST. SURE.

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANTS' EXHIBIT No. 24A

Pillsbury, Madison and Sutro,
Standard Oil Building,
San Francisco, California.

Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York 5, N. Y.

Filed Oct. 23, 1944.

C. W. Calbreath, Clerk.

In the District Court of the United States for the
Northern District of California, Southern
Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER APPROVING DESIGNATIONS BY
THE REORGANIZATION COMMITTEE
UNDER THE PLAN OF REORGANIZA-

Defendants' Exhibit 24A—(Continued)

TION OF THE DEBTOR, OF THE TRUSTEES, TRANSFER AGENTS, REGISTRARS, SCRIP AGENT, DEPOSITARY AND EXCHANGE AGENT AND ENGRAVER AND PRINTER OF SECURITIES FOR PURPOSES OF THE PLAN OF REORGANIZATION AND AUTHORIZING AGREEMENTS OR ARRANGEMENTS PROPOSED BY SAID COMMITTEE FOR THEIR COMPENSATION AND EXPENSES

The petition filed on September 28, 1944, by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, for an order approving designations by the Reorganization Committee of the trustees, transfer agents, registrars, scrip agent, depositary and exchange agent and engraver and printer of securities for purposes of the plan of reorganization and authorizing agreements or arrangements proposed by said Committee for their compensation and expenses, duly came on to be heard and was heard on the 16th day of October, 1944, and has been submitted.

The Court being duly advised in the premises finds that due and proper notice of the hearing upon said petition in the form prescribed by the order of this Court dated and filed on the 29th day

Defendants' Exhibit 24A—(Continued)

of September, 1944, has been admitted by all parties named in said order and that all of the allegations and representations contained in the petition are true. The Court further finds and concludes:

(a) The determinations made by the Reorganization Committee as to the services which will be required in connection with the preparation and initial issuance of the new securities and the deposit of existing securities in connection with carrying out and making effective the plan of reorganization, and of the services to the reorganized company in connection with the securities to be issued under the plan, after its consummation, and the tentative selections made by said Committee of the banking institutions and of an engraver-printer to perform services in said respects, are appropriate for the purposes of the plan and should be approved; and

(b) The arrangements proposed by the Reorganization Committee for the compensation of the several banking institutions which will perform services in connection with the initial issuance of new securities and the consummation of the plan, on the general basis of per piece charges (plus, in some instances, certain expenses), subject to a maximum limit regardless of the number of bond, stock or scrip pieces that may actually be required, are reasonable and appropriate and should be approved.

Defendants' Exhibit 24A—(Continued)

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed:

(1) That the designations of banking institutions tentatively made by the Reorganization Committee, as listed below, be and hereby are approved, subject, in the instance of the Chase National Bank of the City of New York, as New York paying agent and registrar of the new first mortgage bonds, Crocker First National Bank of San Francisco, as San Francisco registrar of the general mortgage bonds and as San Francisco registrar of both the preferred and common stocks, and Wells Fargo Bank & Union Trust Co., as San Francisco transfer agent of both said stocks, to the determination of the Reorganization Committee that the charges which will be made to the reorganized company after the consummation of the plan will be satisfactory, namely: Banking Institutions Approved, Showing Location and Function.

First Mortgage

Crocker First National Bank of San Francisco, Trustee and Registrar, San Francisco.

The Chase National Bank of the City of New York, Paying Agent and Registrar, New York.

General Mortgage

The Chase National Bank of the City of New York, Trustee and Registrar, New York.

Defendants' Exhibit 24A—(Continued)

Crocker First National Bank of San Francisco,
Registrar, San Francisco.

Preferred Stock and Common Stock

Central Hanover Bank and Trust Company,
Transfer Agent, New York.

Wells Fargo Bank & Union Trust Co., Transfer
Agent, San Francisco.

City Bank Farmers Trust Company, Registrar,
New York.

Crocker First National Bank of San Francisco,
Registrar, San Francisco.

Script for General Mortgage Bonds, Preferred
Stock and Common Stock

City Bank Farmers Trust Company, Scrip
Agent, New York.

Consummation of Plan

Guaranty Trust Company of New York, Depository and Exchange Agent, New York.

(2) That the designation tentatively made by the Reorganization Committee of the Security Banknote Company as engraver and printer of the securities required for the consummation of the plan be and hereby is approved.

(3) That the Reorganization Committee be and hereby is authorized to make arrangements, by such Committee resolution or form of agreement as said

Defendants' Exhibit 24A—(Continued)

Committee upon advice of counsel may determine, for compensation to be paid out of the debtor's estate prior to the consummation of the plan, or thereafter by the reorganized company, to said banking institutions and said engraver-printer in connection with the preparation and initial issuance of the new securities and the deposit of existing securities required to carry out and make effective the plan, upon the general basis of a per piece charge (plus, in some instances, certain expenses), subject to a maximum limit regardless of the number of bond, stock or scrip pieces that may actually be required and subject to such modifications of the arrangements proposed in the petition as may be deemed by said Committee to be necessary or appropriate.

Dated: October 23, 1944.

A. F. ST. SURE,
District Judge.

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANT'S EXHIBIT No. 24B

Pillsbury, Madison & Sutro,
Standard Oil Building,
San Francisco, California.

Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York 5, New York.

Filed Oct. 23, 1944

C. W. Calbreath, Clerk

In the District Court of the United States, for the
Northern District of California Southern Di-
vision

No. 26591-S

In the Matter of
THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER MAKING AN ALLOWANCE TO BE
PAID OUT OF THE DEBTOR'S ESTATE
FOR CERTAIN EXPENSES INCURRED
AND TO BE INCURRED IN CONNEC-
TION WITH THE PROCEEDINGS AND
PLAN OF REORGANIZATION BY THE
REORGANIZATION COMMITTEE

The petition filed on September 28, 1944, by Fred-
erick H. Ecker, Frank C. Wright and Robert E.
Coulson, the Reorganization Committee designated
to put into effect and carry out the plan of reorgan-
ization of the debtor above named, for an order
making an allowance to be paid out of the debtor's

Defendant's Exhibit No. 24B—(Continued)

estate for certain expenses incurred and to be incurred in connection with the proceedings and plan of reorganization by the Reorganization Committee, duly came on to be heard and was heard on the 16th day of October, 1944, and has been submitted.

The Court being fully advised in the premises, finds that due and proper notice of the hearing upon said petition in the form prescribed by the order of this Court dated and filed on the 29th day of September, 1944, has been admitted by all parties named in said order and that all of the allegations and representations contained in the petition are true. The Court further finds and concludes:

(a) That, pursuant to Section 77(c) (12) of the Bankruptcy Act, the Interstate Commerce Commission by its order dated September 7, 1944, has fixed the maximum limit for reasonable and necessary expenses of the Reorganization Committee, other than the fees and expenses of the attorneys for said Committee, in the amount of \$197,111.23, of which the amount of \$60,638.48 constitutes the maximum limit fixed for the contingent tax liability described in said order and the amount of \$136,472.75 constitutes the maximum limit fixed for all other purposes, without limitation as to individual amounts with respect to component items, as described in said order;

(b) That for the purpose of enabling the Reorganization Committee to perform its proper functions in an orderly and expeditious manner, the procedure for auditing and payment of bills or

Defendant's Exhibit No. 24B—(Continued)

statements of expenditures, and for the advancement of funds to said Committee, which is set forth in paragraphs 4 and 5 of the petition upon which this order is made, is appropriate and advisable and should be approved.

(c) That certain expenses heretofore incurred by the Reorganization Committee, in the aggregate amount of \$3,144.00, the detail of which was submitted to the Court upon the hearing, were properly incurred and are within the scope of the order of the Interstate Commerce Commission, dated September 7, 1944.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed:

(1) That an allowance to be paid out of the debtor's estate for the actual and reasonable expenses incurred and to be incurred by the Reorganization Committee under the plan of reorganization of The Western Pacific Railroad Company, exclusive of fees and expenses of said Committee's counsel, is hereby made in the aggregate amount of \$197,111.23, or so much thereof as may be required in carrying out the plan, of which the amount of \$60,638.48, or so much thereof as may be required, is allowed for the contingent tax liability described in the order of the Interstate Commerce Commission of September 7, 1944, and the amount of \$136,472.75, is allowed for all other expenses without limitation as to individual amounts with respect to component items, as described in said order;

(2) That the Trustees of the debtor's estate be

Defendant's Exhibit No. 24B—(Continued)
and hereby are directed to reimburse the Reorganization Committee and its officers and members out of the debtor's estate for certain expenditures heretofore incurred by them, in the aggregate amount of \$3,144.00, the detail of which was submitted to the Court upon the hearing.

(3) That further payments of the actual and reasonable expenses of the Reorganization Committee (whether incurred before or after the date of this order) be made out of the debtor's estate by the Trustees thereof, so long as said Trustees are in control of the same, and thereafter by the reorganized company, by the following procedure:

(a) The Reorganization Committee shall approve bills or statements of expenditures by voucher or covering letter, as may be convenient, signed by the Chairman or Secretary of the Committee, and shall submit the same to the Treasurer for the Trustees of the debtor or of the reorganized company, as the case may be;

(b) The Auditor for the Trustees of the debtor or of the reorganized company, as the case may be, shall examine all such bills or statements and, if satisfied they are in order and that the items covered thereby are within the scope of the order of the Interstate Commerce Commission, dated September 7, 1944, shall approve them for payment, subject to the maximum limit of \$136,472.75 contained in said order of said Commission, and said Treasurer shall then make payment of the same upon such approval by said Auditor;

Defendant's Exhibit No. 24B—(Continued)

(c) Said Auditor shall keep a separate and detailed account of all such bills and statements so honored and shall make reports thereof to the Court within a reasonable time after the close of each month in which any such bills or statements are honored;

(4) That funds for the payment of actual and reasonable expenses of the Reorganization Committee may be advanced to it, from time to time, out of the debtor's estate or by the reorganized company, as aforesaid, upon written request to said Treasurer, setting forth the purpose of such advances and signed by the chairman or secretary of said Committee. Said request shall be audited and reported to the Court by said Auditor under the procedure set forth in paragraph (3) of this order. Said Committee shall account to said Auditor, from time to time, for all advances and shall file with him all receipts or other evidences of expenditures paid from such advances, and shall return any unexpended portion thereof to said Treasurer.

(5) All such further payments and advances to the Reorganization Committee under the provisions of this order shall be subject to final approval and allowance by this Court, at such time or times and upon such showing as the Court may direct.

Dated, October 23, 1944.

A. F. ST. SURE,
District Judge.

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANT'S EXHIBIT No. 25

Allan P. Matthew,
1500 Balfour Building,
San Francisco, 4, California.

Filed April 30, 1945,
C. W. Calbreath, Clerk

In the District Court of the United States, for the
Northern District of California, Southern Di-
vision

No. 26591-S

In the Matter of
THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

NINTH AND FINAL REPORT AND AC-
COUNTING BY THE TRUSTEES OF THE
PROPERTY OF THE DEBTOR, AND PE-
TITION FOR APPROVAL OF THEIR
ACTS AND ACCOUNTS, FOR THEIR DIS-
CHARGE AS TRUSTEES AND FOR THE
EXONERATION OF THEIR BONDS

T. M. Schumacher and Sidney M. Ehrman, the
Trustees of the properties of the Debtor above
named, hereinafter referred to as the Trustees,
hereby render their Ninth and Final Report and
Accounting of Their Administration of the Prop-
erties of the Debtor, and Petition for the Approval
of Their Acts and Accounts, for Their Discharge as
Trustees and for the Exoneration of Their Bonds,
as follows:

Defendant's Exhibit No. 25—(Continued)

I.

A statement of account showing the cash receipts and disbursements of the Trustees for the period from January 1, 1944, through December 31, 1944, is attached hereto as Exhibit 1. The Trustees have filed periodically with the Clerk of the Court during the year 1944, copies of monthly reports giving operating results and general statistics of the administration of the property and also monthly general balance sheets. The total railway operating revenues for the entire year of 1944 rose to \$52,849,946.71 from the previous high of \$50,360,509.25 experienced during the preceding year, an increase of \$2,489,437.46. A comparison of such revenues for each of the twelve months of the calendar year 1944, covered by this report, with each of the corresponding months of the calendar year 1943, is shown in the following tabulation:

Total Railroad Operating Revenues

Period	1944	1943	Increase or (Decrease)
January	\$ 4,177,091.30	\$ 2,989,578.50	\$ 1,278,512.80
February	2,755,104.81	2,836,933.05	(81,828.24)
March	4,558,775.54	3,672,138.61	886,636.93
April	4,681,363.78	3,666,868.50	1,014,495.28
May	4,654,846.84	4,000,095.45	654,751.39
June	3,939,439.05	4,218,061.84	(278,622.79)
July	3,605,985.91	4,786,908.83	(1,180,922.92)
August	4,291,967.85	5,257,723.48	(965,755.63)
September	5,120,837.60	4,945,353.58	175,484.02
October	5,446,573.73	4,798,450.96	648,122.77
November	4,961,522.43	4,646,685.92	314,836.51
December	4,656,437.87	4,632,710.53	23,727.34
Calendar Year.....	<u>\$52,849,946.71</u>	<u>\$50,360,509.25</u>	<u>\$ 2,489,437.46</u>

Defendant's Exhibit No. 25—(Continued)

A statement showing the monthly operating revenues, expenses and other items leading to net income, for the calendar year 1944 is attached hereto as Exhibit 2. The volume of freight and passengers carried and revenues received during 1944 were the greatest in the history of the Debtor, and the year 1944 was the fourth consecutive year in which all of the Debtor Company's records for traffic volume and gross revenues were broken. The major portion of such business resulted from handling of war-time traffic. As shown in Exhibit 2 the net income for the year 1944 amounted to \$10,313,502.49 as compared with net income for the preceding year of \$18,505,499.84. (As reported in the eighth report and accounting, no Federal Income or Excess Profits Taxes were accrued in 1943.)

There is attached hereto as Exhibit 3 a statement showing changes in Capital Accounts due to acquisitions, improvements and retirements of property and investments in affiliated companies by months during the calendar year 1944. Capital Accounts were increased during 1944 in the net amount of \$5,433,225.59.

II.

By its order of April 17, 1944, the court authorized the Trustees to do certain addition and betterment work then deemed requisite for normal improvement, operation and maintenance of the railroad of the Debtor during the year 1944 as set forth in the Petition filed by the Trustees on March 29, 1944. The total cost of such work was estimated at

Defendant's Exhibit No. 25—(Continued)

\$2,639,269, of which \$2,112,466 was estimated as chargeable to Capital Account. Due principally to war-time stringency of labor and materials, the Trustees were not able to perform all of the work authorized by the order of April 17, 1944, but progress was made on various projects contemplated by the order which resulted in total charges of \$1,298,437.98 during the year, of which \$1,025,216.66 represents charges to Capital Account.

As the year progressed, the Trustees were confronted with the necessity of performing certain additional improvement work not contemplated when the Court made its order of April 17, 1944. Such additional work was required, for the most part, by the continuing increase in traffic handled and by the need for facilities in connection with war activities and establishments of the Army, Navy and other war agencies. The amount expended during the year 1944 upon such additional work was \$135,807.52 over and above the Contingency Item of \$100,000 approved in said order of April 17, 1944. Of the amount so expended during 1944 the sum of \$101,907.15 represented charges to Capital Account, over and above the similar charges of \$75,000 included as part of said Contingency Item.

Thus the total charges during 1944 for work contemplated by the Court's order of April 17, 1944, together with the charges for such additional work, amounted to \$1,534,245.50 of which \$1,202,123.81 represents charges to Capital Account.

In addition to the expenditures enumerated in

Defendant's Exhibit No. 25—(Continued)

the foregoing paragraph, charges totalling \$1,238,137.66, of which \$850,123.99 represents charges to Capital Account, were incurred during 1944 in connection with projects (exclusive of those enumerated in sections III, IV and V) authorized by various orders of the Court issued prior to 1944 which were carried forward or completed during the year 1944.

III.

By its order of May 3, 1943, the Court authorized the Trustees to install block signals and a centralized traffic control system for more expeditious handling of trains together with appurtenant necessary housing facilities in the Feather River Canyon area between Oroville and Portola, California, at an estimated total cost of \$1,347,612. Work was commenced upon the project during 1943 and was carried forward during 1944. The expenditures upon the project during 1944 totalled \$1,042,093.39 of which \$999,244.69 was chargeable to Capital Account. The aggregate adjusted expenditures on the project during both 1943 and 1944 were \$1,225,721.60 of which \$1,170,775.82 was chargeable to Capital Account. At the close of the year 1944 the greater part of the system was in operation, and at the date of filing this report it is anticipated that the entire system will be in full operation by the month of June, 1945.

IV.

By its order of July 21, 1941, the Court authorized the Trustees to acquire certain rolling stock to wit:

Defendant's Exhibit No. 25—(Continued)

3 Diesel-electric freight locomotives

350 steel box cars

300 steel flat cars

4 stainless steel passenger coaches

and to finance acquisition of such equipment by means of an Equipment Trust. The Diesel-electric freight locomotives were delivered during 1941 and 1942 and the 300 flat cars during 1942 and 1943. By its order of May 15, 1944, the Court authorized the Trustees to pay an estimated increase of \$53,900 in the price for the 350 box cars because of advances in costs of materials and appliances. None of the box cars was delivered during 1944 but at the date of filing this report all of the cars have been received. The 1944 accounts were credited with \$4,342.31 representing discounts on specialties embodied in these cars. The four stainless steel passenger cars authorized by said order of July 21, 1941, have not yet been constructed.

V.

By its order of November 22, 1943, the Court authorized the Trustees to purchase and acquire six 5400 H.P. Diesel-electric freight locomotives from Electro-Motive Division of General Motors Corporation, LaGrange, Illinois, at the approximate cost (including freight, taxes on freight charges, and coach fares for messengers) of \$504,870 per locomotive, or an aggregate of \$3,029,220 for the six locomotives, and to finance the purchase of such locomotives under some form of arrangement there-

Defendant's Exhibit No. 25—(Continued)

after to be determined which would provide for making a down payment of approximately 25% of the cost from funds on hand and borrowing the remainder on terms calling for repayment thereof within approximately five years.

By its order of June 26, 1944, the Court authorized the Trustees to finance the purchase of such Diesel-electric locomotives by a conditional sale agreement with The Chase National Bank of the City of New York in substantially the form submitted to the Court as Exhibit A attached to the petition of the Trustees filed June 13, 1944. The Trustees executed such a conditional sale agreement under date of June 1, 1944, and all of the six locomotives were delivered during the year 1944. The total cost of such locomotives was \$3,030,878.11, of which amount \$3,030,871.17 was chargeable to Capital Account.

VI.

By its order of May 1, 1944, the Court authorized the Trustees to make a contract through competitive bidding for the purchase of 100 freight cars of the so-called mill type of gondola design at an estimated cost of approximately \$3,875 per car, f.o.b. manufacturer's plant, the method of financing the payment of the purchase price to be submitted to the Court for approval. Such a contract was made during 1944 with Mt. Vernon Car Manufacturing Company, the low bidder, at the price of \$3,897.77 Illinois. The Trustees concluded that the entire per car, f.o.b. manufacturer's plant at Mt. Vernon,

Defendant's Exhibit No. 25—(Continued)

Illinois. The Trustees concluded that the entire purchase price of the cars should be paid in cash, thus eliminating the need for submission of any plan for financing the purchase price. None of the cars was delivered during 1944 but at the date of filing this report it is anticipated that deliveries thereof will be completed by June 1, 1945.

VII.

By its order of November 20, 1944, the Court authorized the Trustees to rehabilitate, modernize, enlarge and improve a certain freight facility of the railroad of the Debtor located at 8th and Brannan Streets, San Francisco, California, at an estimated cost of \$58,246, and to amend the lease of said facility then outstanding. The work so authorized was commenced during the calendar year 1944 and the amount expended thereon during that year was \$12,870.09, of which \$9,860.26 was charged to Capital Account. At the date of filing this report such work has been completed and the lease of the facility has been amended as required by said order.

VIII.

Charges during 1944 for preliminary expenses incident to projects included in the program of improvement work for 1945 amounted to \$3,990.27 of which \$3,962.03 represents charges to Capital Account.

Accounting adjustments with respect to charges during years previous to 1944 resulted in total

Defendant's Exhibit No. 25—(Continued)
charges of \$49,670.32 and a credit to Capital Account of \$6,776.72.

Property retired during 1944 resulted in total charges of \$15,411.29 with \$107,734.86 being credited to Capital Account.

IX.

The total of all charges set forth in more detail in Sections II to VIII, both inclusive, in this report, is the net amount of \$6,922,954.32 of which \$5,977,332.06 represented net charges to Capital Account. Details of the latter amount as it was accrued monthly for Road and Equipment and Miscellaneous Physical Property Capital Accounts appear on page 1 of Exhibit 3 attached hereto.

X.

By its order of April 10, 1944, the Court authorized the Trustees to consent to the dissolution of Deep Creek Railroad Company, a subsidiary of the Debtor. Such consent was given and the dissolution of Deep Creek Railroad Company was accomplished during the year 1944.

XI.

The Salt Lake City Union Depot and Railroad Company (hereinafter called the "Depot Company") is a Utah corporation owning a passenger station and terminal facilities in Salt Lake City, Utah. At all times since long prior to the commencement of this proceeding one-half of the outstanding shares of common stock of the Depot Company have been owned by the Debtor and the other

Defendant's Exhibit No. 25—(Continued)

one-half thereof by The Denver and Rio Grande Western Railroad Company and its Reorganization Trustees.

By its order of March 20, 1944, in this proceeding the Court authorized the Debtor and the Trustees to take steps necessary to procure the amendment of the Articles of Incorporation of the Depot Company so that it would be authorized to issue shares of preferred stock having an aggregate par value of \$600,000, subject to the approval of the Interstate Commerce Commission. By said order the Court also authorized the Trustees to purchase one-half of said shares of preferred stock for the sum of \$300,000 in cash upon condition that the Reorganization Trustees of The Denver and Rio Grande Western Railroad Company should concurrently purchase the other one-half of such shares for an equal amount. The approval of the Interstate Commerce Commission was granted and all other conditions stated in said order of March 20, 1944, were fulfilled, and pursuant thereto the Trustees purchased 3,000 shares of the preferred stock of the Depot Company for the sum of \$300,000 in cash during the year 1944. The Depot Company thereupon used funds obtained by the issuance and sale of its preferred stock to discharge all of the indebtedness secured by its first mortgage and to obtain a release thereof.

Thereafter and on June 10, 1944, the Depot Company elected to terminate the lease agreement under which its station and terminal facilities had been used and operated by the Debtor and by The Den-

Defendant's Exhibit No. 25—(Continued)

ver and Rio Grande Western Railroad Company prior to the commencement of this proceeding, which lease had never been affirmed by the Trustees.

By its order of July 24, 1944, the Court authorized the Trustees, subject to approval of the Interstate Commerce Commission, to enter into a lease of the station and terminal facilities of the Depot Company jointly with the Reorganization Trustees of The Denver and Rio Grande Western Railroad Company, such lease to be in substantially the form attached as Exhibit A to the petition of the Trustees filed in this proceeding July 5, 1944. Such proposed lease was thereafter approved by the Interstate Commerce Commission, and the lease was thereupon executed by all parties thereto under date of December 1, 1944.

By its order of September 18, 1944, the Court authorized the Trustees to make a final settlement with the Depot Company for the use of its premises by the Trustees for the period ending immediately prior to the effective date of the new lease hereinabove described. Such settlement has been accomplished.

XII.

By its order of March 3, 1944, the Court authorized the Trustees to establish, with funds derived from the earnings of the railroad of the Debtor during the year 1943, a "reserve fund for contingent tax liabilities" in the amount of \$7,100,000 to be invested in United States Treasury Securities and to be used for payment of any Federal income and ex-

Defendant's Exhibit No. 25—(Continued)

cess profits taxes which might thereafter be found due for the year 1943. During the year 1944 such a fund was established and was invested in United States Treasury Securities.

By its order of May 15, 1944, the Court directed that as funds accumulated in the hands of the Trustees from month to month during the year 1944 for the payment of estimated Federal income and excess profits taxes accruing during that year, the Trustees should invest such funds from time to time in United States Treasury Savings Notes, Series C, to be used for the payment of such taxes as and when liability therefor should mature. Accordingly funds in the aggregate amount of \$7,810,000 were invested by the Trustees in such Savings Notes during the year 1944.

XIII.

By its order of June 26, 1944, the Court authorized the Trustees to make, execute and deliver to certain named persons quitclaim deeds covering the right-of-way formerly occupied by the so-called Calpine Branch of the railroad of the Debtor, said Calpine Branch having been abandoned pursuant to this Court's order of February 26, 1940, and a subsequent order of the Interstate Commerce Commission. Such quitclaim deeds were made, executed and delivered during the year 1944.

XIV.

By its order of July 24, 1944, the Court authorized the Trustees to stipulate for judgment in a cer-

Defendant's Exhibit No. 25—(Continued)

tain condemnation action then pending in the District Court of the United States for the Northern District of California, Northern Division, entitled "United States of America, Plaintiff, vs. 450 Acres of Land in San Joaquin County, California, Irene Louise Brichetti, et al., Defendants" and numbered No. 4456. Such stipulation was given and judgment thereon was entered during the year 1944.

XV.

By its order of June 2, 1944, upon petition of the Trustees and the Reorganization Committee hereinafter described, the Court approved and authorized irrevocable agreements with the Commissioner of Internal Revenue of the United States for the establishment of depreciation accounting with respect to certain road properties of the railroad of the Debtor and certain subsidiaries of the Debtor. During the year 1944 agreements were made with the Commissioner of Internal Revenue in accordance with the authority granted by said order.

XVI.

A.—Leases by Trustees in Reorganization

Incidentally to the operation and maintenance of the railroad of the Debtor, the Trustees have made and entered into the following leases as Lessors during the period from January 1, 1944, to December 31, 1944, both inclusive.

1—Lease, dated January 1, 1944, for term ending December 31, 1944, with option of renewal, to Moore Dry Dock Company, covering several parcels of

Defendant's Exhibit No. 25—(Continued)

land at Oakland, California, at a rental of \$46,522.25 per year.

2—Renewal of Lease, dated June 22, 1943, (Renewal dated March 24, 1944) for term April 15, 1944, to April 15, 1945, to Soule Steel Company, covering parcel of land at Army and Indiana Streets, San Francisco, California, at a rental of \$625.00 per month.

3—Renewal of Lease, dated August 26, 1942, (Renewal dated May 31, 1944) for term July 1, 1944, to July 1, 1945, to United States of America, covering warehouse and land at northwest corner 9th and Brannan Streets, San Francisco, California, at a rental of \$2,083.33 per month.

4—Lease, dated July 8, 1944, for term ending April 30, 1945, to L. H. Butcher Company, covering space in warehouse at 15th and Vermont Streets, San Francisco, California, at a rental of \$640.63 per month.

5—Lease, dated August 9, 1944, for term ending June 14, 1949, to Merchant Shippers Association, covering warehouse at 4th and Oak Streets, Oakland, California, at a rental of \$186.84 per month.

6—Lease, dated September 6, 1944, for term ending April 30, 1949, to F. E. Booth Company, Inc., covering 55,980 sq. ft. of land at 3rd and Marin streets, San Francisco, California, at a rental of \$233.25 per month.

7—Lease, dated September 6, 1944, for term ending June 18, 1947, to Encinal Terminals, covering warehouse at San Leandro St. and 42nd Ave., Oakland, California, at a rental of \$213.67 per month.

Defendant's Exhibit No. 25—(Continued)

B—Leases to Trustees in Reorganization

Incidentally to the operation and maintenance of the railroad of the Debtor, the Trustees have made and entered into the following leases as Lessees during the period from January 1, 1944, to December 31, 1944, both inclusive:

1—Lease to Trustees from General Motors Corporation, dated January 31, 1944, covering General Agent's offices in Detroit, Michigan, for three years from March 1, 1944, at a monthly rental of \$188.00.

2—Lease to Trustees from Railway Exchange Building, Inc., dated March 14, 1944, covering General Agent's offices in St. Louis, Mo., for two years from May 1, 1944, at a monthly rental of \$110.00.

3—Lease to Trustees from Nettie Aronson, dated June 17, 1944, covering Signal Department offices at 16 First Street, San Francisco, California, for one year from July 15, 1944, at a monthly rental of \$125.00.

4. Lease to Trustees from Western Title Insurance Company, dated November 10, 1944, covering General Offices on 5th Floor at 516 Mission Street, San Francisco, California, for two years from November 15, 1944, at a monthly rental of \$135.00 for the first year and \$140.00 per month for the second year.

5. Lease to Trustees from Ollie Day, dated December 30, 1944, covering employees' rooming house at Elko, Nevada, for one year from November 1, 1944, at a monthly rental of \$100.00.

Defendant's Exhibit No. 25—(Continued)

6—Lease to Trustees from Rosine F. Klucny, dated December 30, 1944, covering employees' rooming house at Winnemucca, Nevada, for one year from November 1, 1944, at a monthly rental of \$150.00.

C—Deeds by Trustees in Reorganization

Pursuant to the Court's order of April 10, 1944, the Trustees sold and conveyed certain non-operative real property included in the estate of the Debtor and located in San Francisco, California, to Safeway Stores, Incorporated, by a grant deed dated April 18, 1944, for the sum of \$7,189.77.

Pursuant to the Court's order of October 16, 1944, and the order of the Railroad Commission of the State of California dated October 3, 1944, the Trustees were authorized to sell and convey certain operative property included in the estate of the Debtor and located in San Joaquin County, California, to Woodbridge Vineyard Association by a grant deed dated November 20, 1944, for the sum of \$671.25. The sale was not finally consummated and the title passed until March 5, 1945.

The Trustees have also made the following conveyances during the year 1944:

1—Quitclaim Deed, dated July 1, 1944, to J. J. McPherrin, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

2—Quitclaim Deed, dated July 1, 1944, to United States of America, conveying a strip of right of

Defendant's Exhibit No. 25—(Continued)
way on the abandoned Calpine Branch in California. No monetary consideration.

3—Quitclaim Deed, dated July 1, 1944, to Veste Nelson, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

4—Quitclaim Deed, dated July 1, 1944, to Giacomo Folchi, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

5—Quitclaim Deed, dated July 1, 1944, to Letitia Webster Havey, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

6—Quitclaim Deed, dated July 1, 1944, to Wilbur Dewey Johnson, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

7—Quitclaim Deed, dated July 1, 1944, to Westover Company, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

8—Quitclaim Deed, dated July 1, 1944, to Chas. W. Ede, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

9—Quitclaim Deed, Dated July 1, 1944, to J. J. and O. B. Farrar, conveying a strip of right of way on the abandoned Calpine Branch in California. No monetary consideration.

10—Quitclaim Deed, dated September 11, 1944, to

Defendant's Exhibit No. 25—(Continued)

California Prune & Apricot Growers Association, to clear title of Grantee, property at San Jose, California. No monetary consideration.

D—Deeds to Trustees in Reorganization

The Trustees have also, incidentally to the operation and maintenance of the railroad of the Debtor, acquired certain real property during said period, as follows:

1—Quitclaim Deed, dated April 1, 1944, from Edwa D. Ewing Boggs to the Trustees for clearing title to land at Stockton, California. No monetary consideration.

2—Deed, dated April 12, 1944, from City of Elko to Trustees for railroad yard expansion at Elko, Nevada. Consideration \$3,000.00.

3—Deed, dated July 12, 1944, from Otto A. and Genevieve R. Riffel to Trustees for residence for railroad employee at Blairsden, California. Consideration \$5,000.00.

4—Quitclaim deed, dated September 7, 1943, (although dated in 1943, transaction was not closed until 1944) from The Lang Company to Trustees for clearing title in connection with closing a street at Salt Lake City, Utah. No monetary consideration.

5—Deed, dated October 3, 1944, from City of Winnemucca to Trustees for railroad yard expansion at Winnemucca, Nevada. Consideration \$450.00.

6. Deed, dated December 6, 1944, from Western Realty Company to Trustees for residence for rail-

Defendant's Exhibit No. 25—(Continued)
road employee at Spring Garden. Consideration
\$100.00.

E—Easements Acquired by Trustees
in Reorganization

The Trustees have also, incidentally to the operation and maintenance of the railroad of the Debtor, acquired easements during the year 1944 over three separate pieces of real property for the purposes stated below, as follows:

1—Easement, dated July 31, 1942, (although dated in 1942, the transaction was not closed until 1944), from Peter Paul, Inc., to Central Pacific Railway and Trustees, jointly, for right of way for Industrial Lead Track from the Joint Drill Track of the Southern Pacific Company and The Western Pacific Railroad Company at Oakland, California. No monetary consideration.

2—Easement, dated January 20, 1943, (although dated in 1943, the transaction was not closed until 1944), from Loose-Wiles Biscuit Company to Central Pacific Railway and Trustees, jointly, for right of way for Industrial Lead Track from the Joint Drill Track of the Southern Pacific Company and The Western Pacific Railroad Company at Oakland, California. No monetary consideration.

3—Easement, dated October 31, 1943, (although dated in 1943, the transaction was not closed until 1944), from Frederickson & Watson Construction Company and Riviera Packing Company to Central Pacific Railway and Trustees, jointly, for right of

Defendant's Exhibit No. 25—(Continued)

way for Industrial Lead Track from the Joint Drill Track of the Southern Pacific and The Western Pacific Railroad Company at Oakland, California. No monetary consideration.

F—Easements Granted by Trustees
in Reorganization

The Trustees have also, incidentally to the operation and maintenance of the railroad of the Debtor, granted the following easements during the year 1944:

1—Easement, dated September 14, 1943, from Trustees to United States of America, for chlorinator house, pressure regulating station, water pipe lines and electric power line in connection with Bombing Base at Wendover, Utah. No monetary consideration.

2. Easement, dated February 25, 1944, from Trustees to Henry J. Kaiser Company for gravel conveyor at Radum, California. No monetary consideration.

3—Easement, dated June 26, 1944, from Trustees to American Telephone & Telegraph Company for underground conduit along right of way between Wendover and Barro, Utah. Consideration \$611.18.

4—Easement, dated July 6, 1944, from Trustees to County of Plumas for highway to Keddie, California. No monetary consideration.

5—Easement, dated July 12, 1944, from Trustees to American Telephone and Telegraph Company for underground conduit crossings in vicinity of Barro, Utah. Consideration \$28.60,

Defendant's Exhibit No. 25—(Continued)

6—Easement, dated September 28, 1944, from Trustees to E. I. Lane for roadway at Portola, California. No monetary consideration.

7—Easement, dated October 4, 1944, from Trustees to Oro Loma Sanitary District for sanitary sewer at three locations in the vicinity of San Leandro, California. No monetary consideration.

8—Easement, dated October 30, 1944, from Trustees to State of California for State Highway near Chilcoot, California. Considerations \$51.10.

9—Easement, dated November 2, 1944, from Trustees to State of Nevada for State Highway near Preble, Nevada. No monetary consideration.

10—Easement, dated November 28, 1944, from Trustees to State of Utah for State Highway at Wendover, Utah. No monetary consideration.

11—Easement, dated December 12, 1944, from Trustees to Red River Lumber Co. for underground telephone line, power line, water pipe line and transformers at Mile Post 36.41 on the Northern California Extension, California.

XVII.

During the year 1944 the reorganization plan confirmed by the order of this Court dated October 11, 1943, was placed in effect under the direction of the Reorganization Committee consisting of Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, whose designation as members of the Reorganization Committee was approved by said order of October 11, 1943.

Defendant's Exhibit No. 25—(Continued)

By its order of November 27, 1944, this Court among other things directed the revesting of the properties of the Debtor in the Debtor Company, and more particularly, directed the Trustees to execute, acknowledge and deliver to the Debtor Company on or before December 28, 1944, as requested by the Reorganization Committee, a deed substantially in the form attached to said order as Exhibit "A," releasing and transferring to the Debtor Company as of 12:01 a.m. Pacific War Time on December 29, 1944, title to all property, rights and interests of every kind and description held by them as such Trustees. Pursuant to such order and the request of the Reorganization Committee the Trustees executed and acknowledged such a deed and delivered it to the Debtor Company prior to December 28, 1944, thereupon divesting the Trustees of all title to all properties and assets held by them as Trustees in this proceeding and vesting such title to all thereof in the Debtor Company. In exchange for said deed the Trustees received from the Debtor Company an agreement, substantially in the form of Exhibit "D" attached to said order of November 27, 1944, whereby the Debtor Company assumed and agreed to perform all contracts, leases, agreements, liabilities and obligations of the Trustees remaining in effect on December 31, 1944. Paragraph 12 of said order of November 27, 1944, authorized and directed the Trustees to continue their control and operation of the Debtor's business and properties until 12:00 o'clock midnight, Pacific War Time, on

Defendant's Exhibit No. 25—(Continued)

December 31, 1944, at which time all right and duty of the Trustees to possess, control or operate said business and properties should cease. The Trustees did retain control and operation of the Debtor's business and properties until 12:00 o'clock midnight, Pacific War Time, on December 31, 1944, whereupon, as directed by said order, the Trustees ceased to possess, control and operate said business and properties, and all possession, control or operation of said business and properties or any thereof by the Trustees, or either of them, ceased and terminated. Possession, control and operation of all said business and properties were then and thereby transferred to and accepted by the Debtor Company at 12:00 o'clock midnight, Pacific War Time, on December 31, 1944.

At or prior to the end of the year 1944 the Trustees divested themselves of, and transferred and conveyed to and vested in the Debtor Company, all title to and all possession, control and operation of the business and properties theretofore held by the Trustees in this proceeding, all as required by orders of this Court. All duties, obligations, services and responsibilities of the Trustees in this proceeding have been duly and fully performed and completed, save only the execution of any further instruments of conveyance, transfer, substitution or release which may be requested by the Debtor Company in order to implement, consummate, confirm or further evidence the complete and effective transfer to the Debtor Company of all of the business, properties, assets, contracts, agreements, leases, actions, rights

Defendant's Exhibit No. 25—(Continued)
and claims heretofore held by the Trustees in this proceeding.

XVIII.

This proceeding has been pending in this Court continuously since August 2, 1935, and your petitioners have been the duly appointed, qualified and acting Trustees of the properties of the Debtor in this proceeding at all times since their appointment and qualification as such on November 13, 1935. During the intervening period of more than nine years the railroad of the Debtor has been operated by your petitioners under the control and supervision of this Court. Your petitioners have caused to be compiled a summary of the operations of the railroad, business and properties of the Debtor during the pendency of this proceeding. Copies of such summary will be furnished to this Court and to each of the parties to this proceeding upon or prior to the hearing upon this Report and Accounting.

Wherefore, the Trustees pray (1) that their Ninth and Final Report and Accounting and all of their acts and accounts be approved and confirmed; (2) that they be discharged as Trustees, reserving to them, jointly and to each of them separately, and to the survivor of them, the power and authority thereafter to execute and deliver such instruments of conveyance, transfer, substitution or release as may be requested by the Debtor Company from time to time in order to implement, consummate, confirm or further evidence the complete and effective release, transfer and conveyance to the Debtor Com-

Defendant's Exhibit No. 25—(Continued)

pany of all the business, properties, assets, contracts, agreements, leases, actions, rights and claims held by the Trustees in this proceeding, provided that the Trustees shall have the right but shall not be required to submit any such instruments to this Court for approval prior to the execution and delivery thereof, jurisdiction to be reserved by this Court for such purposes; (3) that notwithstanding their discharge the Trustees be authorized at any time upon the request of the Debtor Company to cooperate with the Debtor Company in any and every suit, litigation, proceeding, controversy or compromise in which their cooperation as such Trustees may appear necessary or desirable; (4) that the bonds hertofore given by the Trustees in this proceeding be exonerated; and (5) that such other or different order or orders be made as to the Court may seem meet and proper.

ALLAN P. MATTHEW,

Counsel for T. M. Schumacher and Sidney M. Ehrman, Trustees in Reorganization.

State of California,

City and County of San Francisco—ss.

Sidney M. Ehrman, being first duly sworn, deposes and says that he is one of the Trustees named in and making the foregoing Ninth and Final Report and Accounting by the Trustees of the Property of the Debtor and Petition for Approval of Their Acts and Accounts, for Their Discharge as Trustees and for the Exoneration of their Bonds;

Defendant's Exhibit No. 25—(Continued)

that he has read the foregoing Ninth and Final Report and Accounting and Petition, including the exhibits attached thereto, and knows the contents thereof, and that they are true of his own knowledge.

/s/ SIDNEY M. EHRMAN.

Subscribed and sworn to before me this 30th day of April, 1945.

[Seal] FRANK L. OWEN,

Notary Public in and for the City and County of San Francisco, State of California.

EXHIBIT 1

T. M. Schumacher and Sidney M. Ehrman, Trustees in Reorganization of The Western Pacific Railroad Company

Statement of Cash Receipts and Disbursements
January 1, 1944, to December 31, 1944

Cash on hand and in banks January 1, 1944..... \$ 14,435,248.59

Receipts

Agents and conductors	\$28,085,007.26
Foreign roads—Freight traffic balances	12,155,596.96
Foreign roads—Passenger traffic balances	909,452.42
Foreign roads—Car service.....	129,340.35
Foreign roads—Freight claim settle- ments	399,844.05
Individuals and companies	3,224,856.22
Railway Express Agency, Inc.	219,481.70
United States Government— Transportation charges	38,998,547.95
Working fund advances	1,175.09
Hospital fund collections	2,271.75
Railway Express Agency, Inc.— Interest on advances	2,130.78
Interest on bank balances, time deposits, etc.	1,475.40

Defendant's Exhibit No. 25—(Continued)

Tidewater Southern Railway Co.—		
Principal of Note	508,278.61	
Tidewater Southern Railway Co.—		
Interest on Note	29,649.59	
Deep Creek Railroad Co.—		
Return of cash advances.....	23,935.55	
Standard Realty and Development Co.—		
Return of cash advances	60,000.00	
Central California Traction Co.—		
Return of cash advances	50,000.00	
Sacramento Northern Railway—		
Return of cash advances	170,000.00	
Oakland Terminal Railway—Proportion		
of income and profit and loss.....	18,653.34	
U.S. Government, Railroad		
Retirement Board—Services	24.00	
Cash collected for U.S. War Bonds sold	263,991.88	
Interest on Equipment Trust Funds		
invested in U.S. Government Bonds..	11,750.00	
Collections from various sources in con-		
nection with consumation of the Plan		
of Reorganization		
Reconstruction Finance		
Corporation	7,075,000.00	
Crocker First National Bank of		
San Francisco	1,076,114.20	
Irving Trust Company of New York	982,437.13	94,399,014.23
Total Receipts.....		\$108,834,262.82

Disbursements

Foreign roads—Freight traffic balances	\$21,358,755.75
Foreign roads—Passenger traffic	
balances	1,656,553.80
Foreign roads—Car service traffic	
balances	1,877,187.04
Foreign roads—Freight claim	
settlements	272,744.62
Paychecks and payroll deductions	17,389,876.46
Agents drafts on Treasurer for payment	
of steamship companies' charges and	
other purposes	2,710,272.45
Drafts in settlement of freight claims....	320,209.48
Claim agents drafts	144,728.81
Ticket redemption drafts	122,483.25
Outside agency drafts	56,879.32
Purchase of U.S. Government Savings	
Notes "C"	7,100,000.00

Defendant's Exhibit No. 25—(Continued)

Audited Vouchers, exclusive of payroll deductions as per accompanying statements	35,127,996.71	
Deposited with the Guaranty Trust Company of New York for payment of cash adjustments in connection with exchange of securities at consummation of the Plan of Reorganization	12,681,258.52	\$100,818,946.21
Cash on hand and in banks December 31, 1944	\$	8,015,316.61

Statement of Voucher Payments, Exclusive of Pay Roll Deductions,
January 1st, 1944, to December 31st, 1944

Fuel oil	\$ 2,705,528.91
Coal	319,271.17
Rail (New)	221,041.83
Rail (Relay)	1,788.27
Rail joints	31,078.71
Tie plates	23,880.02
Rail anchors and anti-creepers	8,549.58
Bolts, spikes and nuts	51,470.68
Crossings and other track material	1,791.00
Lock washers	2,817.92
Switch material	59,245.83
Rail bonds	4,279.12
Ballast	181,969.97
Lumber and ties	661,987.15
Culvert pipe	4,236.40
Stand pipe	771.42
Cement	18,977.29
Cross arms	5,588.64
Steel pipe	32,725.85
Wire	13,605.40
Water tanks	1,838.85
Cable	1,985.98
Pumps	8,501.32
Ranges	3,137.01
Smoke jacks	1,272.04
Signal material	4,316.26
Locomotive repair parts	191,464.85
Diesel locomotive repair parts	175,016.45
Lagging	3,107.91
Brass castings	58,580.41
Battery renewals	44,348.80
Iron and steel	86,368.79
Babbitt	7,305.20
Flake and Okeamo	13,780.78
Tools	73,452.36

Defendant's Exhibit No. 25—(Continued)

Acetylene and oxygen	25,771.30
Solder	1,506.19
Car repair parts	50,171.45
Car wheels and axles	53,135.26
Brake shoes	34,512.60
Burlap	1,857.10
Canvas and duck	5,476.38
Blankets and mattresses	9,266.69
Shop machinery	52,082.79
Roadway machinery	34,238.78
Fusees and torpedoes	50,813.97
Rags and waste	22,214.61
Oil and grease	164,848.14
Chemicals for water treatment	35,225.16
Chemicals for killing weeds	8,118.01
Switch lists and train orders	2,588.46
Tickets	10,374.78
Timecards and time tables	3,968.46
Teletype sets	6,006.80
Dining car and hotel supplies	462,682.77
Hospital services and supplies	148,243.92
Ice, salt, and refrigeration expenses	506,870.07
Central traffic control equipment	643,465.48
Real estate	11,028.39
Fencing	6,234.61
Electrodes	230.63
Winpower electric plants	1,245.58
Steel piling	12,051.34
Ferry slip repair parts.....	1,165.22
Duplicating machine	2,673.69
Purchase of Capital Stock, The Salt Lake City Union Depot and Railroad Company—3000 shares 4% Pre- ferred	300,000.00
Purchase of 4 Diesel electric switching locomotives, Nos. 555 to 558 inc.	311,419.68
Purchase of 10 Insulated box cars	9,500.00
Purchase of Hotel furniture and equipment at Portola...	6,000.00
Purchase of six Diesel electric freight locomotives through conditional sale contract with The Chase Na- tional Bank, New York—25% of certified cost.....	782,820.00
Purchase of U.S. Treasury Savings Notes Series "C" Account Maintenance Fund	1,073,000.00
Account Federal Income Tax Accruals	7,810,000.00
Purchase of U.S. War Bonds sold for cash.....	263,991.88
U.S. War Bonds, undelivered	20,081.25
Tug service for car barges—San Francisco Bay.....	60,427.50
San Francisco Harbor—Rents, tolls and State Belt Ry. switching	175,368.26
Services of express messengers as train baggagemen.....	21,647.59

Defendant's Exhibit No. 25—(Continued)

Oroville shop, bus service for employes.....	9,600.00
Welding service	18,341.25
Contract telegraph service, Western Union	15,587.35
Threlkeld Commissary Co.—Operating deficits.....	129,126.41
Testing rails	9,461.20
Expenses Mexican National Laborers.....	72,222.17
Group Advertising	48,187.37
Repairs, tugs and barges	125,486.85
Foreign cars destroyed	25,896.67
Insurance premiums	200,739.89
Foreign roads, traffic balances	120,086.96
Overcharges refunded U.S. Government	670,313.49
Fire damage U.S. Government Forests	3,386.51
U.S. Government fines	1,168.20
Fire damage, Oroville packing house	5,442.34
Compensation of T. M. Schumacher as Reorganization Trustee	15,000.00
Expenses of T. M. Schumacher as Reorganization Trustee	2,432.64
Compensation of Sidney M. Ehrman as Reorganization Trustee	12,000.00
Compensation of Allan P. Matthew as General Counsel for Reorganization Trustees	18,000.00
New York Office, Salaries, rents and other expenses	34,839.65
Traveling, hotel, automobile, and similar expenses of offi- cers and employes on behalf of The Western Pacific Railroad including all branches of company service approximately 400 individual accounts per month	373,869.30
Handling celery refuse at Terminous	2,241.00
Repairs Business Car No. 101	983.46
Fire hazard reduction U.S. National Forests	16,154.41
Excess mileage of tank cars	24,696.47
Damage claims Greyhound Bus Company	10,000.00
Payments to A—Southern Pacific Company	1,060,413.70
B—Atchison, Topeka and Santa Fe Railway Co.	45,510.71
C—Great Northern Railway Co.	261,964.13
D—McCloud River Railroad Co.	2,968.96
E—The Denver and Rio Grande Western Railroad Co.	1,139,822.94
F—The Salt Lake City Union Depot and Railroad Co.	70,742.50
(For operation of joint facilities, re- pairs to Western Pacific equipment, and joint facility rents)	
Advances to subsidiary companies to enable them to meet current obligations including operating expenses,	

Defendant's Exhibit No. 25—(Continued)

taxes, interest, and maintenance of adequate cash working funds		
Alameda Belt Line, Capital expenditures	\$26,665.14	
Operations	68,084.86	94,750.00
Sacramento Northern Railway		220,000.00
Central California Traction Company		48,000.00
Interest—Equipment Trust, Series of 1937		39,375.00
Principal—Equipment Trust, Series of 1937		155,000.00
Interest—Equipment Trust Series of 1941		37,100.00
Principal—Equipment Trust Series of 1941		265,000.00
Interest—Conditional Sale Contract with The Chase National Bank covering six steam freight locomotives		14,335.50
Principal—Conditional Sale Contract with The Chase National Bank covering six steam freight locomotives..		181,080.00
Interest—Conditional Sale Contract with The Chase National Bank covering three Diesel electric freight locomotives		18,333.00
Principal—Conditional Sale Contract with The Chase National Bank covering three Diesel electric freight locomotives		226,800.00
Interest—Conditional Sale Contract with The Chase National Bank covering six Diesel electric freight locomotives		14,633.49
Principal—Conditional Sale Contract with The Chase National Bank covering six Diesel electric freight locomotives		187,200.00
Interest—Trustees Certificates		124,369.54
Principal—Trustees Certificates		300,000.00
Interest on Central California Traction Co. Bonds, viz:		13,500.00
Payment of semi-annual interest due April 1, and October 1, 1944, upon Central California Traction Company 5% First Mortgage Bonds in the face amount of \$270,000, which matured April 1, 1936, are owned by The Western Pacific Railroad Company and are now pledged with and in the possession of Irving Trust Company as Trustee under the General and Refunding Mortgage of The Western Pacific Railroad Company, dated as of January 1, 1932, as collateral under said mortgage, being interest from October 1, 1943, to and including September 30, 1944, on said bonds, at the same interest rate as said bonds bore prior to maturity.		
Interest and principal collected on Tidewater Southern Railway Company Note, deposited with Irving Trust Company of New York, Trustee, The Western Pacific Railroad Company, General and principal.....		508,278.61
Refunding Mortgage interest		29,649.59
Crocker First National Bank of San Francisco, and Samuel Armstrong, Trustees, The Western Pacific Railroad		

Defendant's Exhibit No. 25—(Continued)

Company, First Mortgage Deposits in lieu of mortgaged property sold

Safeway Stores, Land in San Francisco	7,189.77
Deposits of rentals collected	
Moore Dry Dock Company, Oakland	7,834.79
Advances to the Reorganization Committee	15,987.71
Rentals for general offices and outside agencies	99,752.08
Rental for Oakland waterfront land	2,000.00
Rental for United States tank cars (Milcage)	5,112.93
Rental for locomotives	104,049.04
Rental for buses	2,462.31
Taxes, State, County, etc.	1,039,057.21
Taxes, Sales	34,528.40
Federal Income tax collections	2,293,656.51
Federal Transportation tax collections	922,326.01
Payments account of Railroad Retirement Board	1,201,294.17
Payments account of Social Security Board Unemployment Reserves	553,900.00
Payments to contractors account of improvements, etc.	
Extension of operators quarters at Pulga	977.00
Oakland commissary	1,238.39
Passenger platform Sacramento	6,068.25
Freight Shed, San Jose	808.90
Roundhouse, and drop table, Oroville	54,820.76
Roundhouse, Elko	41,532.10
Roundhouse, Stockton	12,071.50
Roundhouse, Oakland and new turntable	71,384.17
Freight house, Stockton	14,808.15
Stationery store Oakland	2,567.76
Yard tracks, Portola	44,284.80
Yard Office, Oroville	8,990.69
Painting, Bridges Various	4,220.64
Buildings, Fruitvale, Livermore	1,158.00
Buildings, Oakland	2,332.00
Buildings, various, Eastern Division	31,636.75
Warehouse San Francisco	1,077.00
Alterations, Freight office, San Francisco	4,512.00
Passenger station, Stockton	1,729.00
Packing shed, Thornton	2,531.00
Packing shed, San Jose	11,157.98
Ticket office, Sacramento station	3,516.43
Grading Oroville Yard	2,491.00
Buena Vista	375.00
Herlong	1,500.00
Oakland	1,188.04
San Francisco	11,677.67
Elko Yard	12,203.43
Winnemucca Yard	11,287.12

Defendant's Exhibit No. 25—(Continued)

Payments to contractors account of improvements, etc. (Cont.)

Construction Roadway Oakland Mole	19,107.80
Signal tower, Keddie	4,537.25
Frame dwellings, various points	16,282.11
Depot, Warner	6,394.00
Carmen's house Stockton	845.00
Pipeline, Sacramento Shops	1,233.00
Foundations, Central Traffic Control	19,261.75
Culverts, various points	29,404.90
Roof, Freight Platform, San Francisco	345.37
Section facilities, various points	47,404.25
Station platform, Pleasanton	2,988.58
Frame buildings, Nevada	7,642.38
Bunkhouse, Chilcoot	2,686.00
Depot, Wells	7,043.02
Passing track, Carlin	691.26
Track, San Francisco	1,178.00
Flood gate, Marysville	912.00
Tin shop, Elko	427.18
Trainmaster's office, Salt Lake City	867.61
Toolhouse, Oakland	561.19
Drain, San Francisco Freight house	1,589.45
Rest room, General Store Sacramento	1,523.30
Barrier posts, Oakland	611.57
Operators quarters, Warner	1,424.00
Warehouses, Oakland	61,612.00
Driveway, Pleasanton	807.00
Yard office, San Francisco	8,566.00
Section facilities, San Francisco	16,862.50
Toilet, Stockton Yard	2,350.62
Section facilities, Oakland	25,156.37
Oil house, San Francisco	490.00
Section facilities, Eastern Division	43,286.00
Yard tracks, Elko	25,763.53
Diesel enginehouse, San Francisco	24,000.00
Dispatchers office, Keddie	16,183.71
Passing track Dyke	4,912.00
Transformer house, Portola	595.00
Driveway Oakland Warehouses	6,676.45
Concrete platform, Oroville	5,571.37
Elevator, Sacramento Store	3,170.00
Platform, Decota	3,631.17
Division office, Sacramento	2,952.00
Dwelling, Spring Garden	5,367.75
Interchange office, San Francisco	1,414.50
Garage, Oakland	990.45
Fuel reservoir, Sacramento	4,266.00
Car inspectors building, Stockton	3,357.00
Oil tank, Wendover	7,177.50

Defendant's Exhibit No. 25—(Continued)

Payments to contractors account of improvements, etc. (Cont.)

Construction Repairs Packing sheds, Milpitas.....	671.62
Platform, Sacramento	454.00
Bridge 178.18	24,029.87
Bridge, 363.35	33,579.37
Passenger station, Sacramento	7,529.43
Buildings, Reno	547.25
Freight house and shed, San Francisco	10,471.33
Embankments, Eastern Division	120,700.52
Warehouses, San Francisco	5,188.24
Dock, Oakland Mole	57,224.69
25th St. Wharf, San Francisco.....	67,128.64
Wharf, Stockton	11,398.13
Lumber shed, Sacramento	2,015.00
Hotel, Portola	3,171.00
Freight house, Stockton	5,846.49
Tunnel No. 15	97,748.60
Station, Marysville	17,688.83
Roadway, Crescent Mills	3,953.87
Clearing Slide, Virgilia	15,895.90
Re-arrangement of tracks, Oakland	1,890.00
Roadway, San Jose	713.63
Oakland Commissary	1,324.62
Roadway, David	9,962.19
Roadway, Carboard	2,344.03
Roundhouse, Oroville	11,965.05
Freight house, Winnemucca	1,040.00
Clearing slide, Red Rock	2,153.28
Re-locate carmen's shed, San Francisco	546.83
Onion platform, Stockton	782.65
Yard track, San Francisco	993.88
Roundhouse, Oakland	4,976.50
Loading platform, Stockton	1,819.45
Roadway, Oakland Mole	4,838.40
Freight house, Oroville	1,063.39
Platform, San Francisco.....	576.16
Packing shed, Terminous	15,326.26
Auto platform, San Francisco	750.00
Pipe Line, Senoke Creek	4,757.10
Embankments various locations	17,961.66
Warehouse, Stockton	2,475.00
Dispatchers Circuit, Western Division	1,470.00
Stock yard, Winnemucca	914.98
Pipe Line, Cottonwood Springs	2,309.72
Removing rocks, San Francisco	619.35
Salvaging wire from Sacramento Northern Railway	399.50
Digging drainage ditch, Sacramento	647.50
Drilling well, Jungo	5,360.00
Lighting fixtures, various stations	7,371.00
Harvesting ice crop, Carlin	32,906.81

Defendant's Exhibit No. 25—(Continued)

Payments to contractors account of improvements, etc. (Cont.)

Erection temporary camp, San Francisco	4,241.00	
Paving and street work, San Francisco	11,751.79	
Oakland	5,718.96	
Stockton	7,333.12	
Marysville	1,738.10	
San Jose	3,503.22	
Fitting up city ticket office, San Francisco	540.75	

Fees and expenses of financial institutions as Trustees,
Agents, etc., as follows:

The Chase National Bank of New York

Equipment Trust Series "D"

Services in redemption of

certificates\$73.00

Services account of cremation 1.10

Services in execution of assignment.. 75.00

Expenses in execution of assignment 27.00 176.10

The Western Pacific Railroad Company, First Mortgage

Services as Attorney in fact for

Samuel Armstrong, Individual

Trustee200.00

Services as Registrar150.00

Services in execution of release

from Mortgage100.00

Expenses in execution of release

from Mortgage 40.00

Services account register and

transfer of bonds 10.20

Services account authentication

of bonds 26.00

Expenses postage and insurance 12.05 538.25

714.35

Crocker First National Bank, San Francisco, Trustee

The Western Pacific Railroad Company, First

Mortgage

Services as Trustee2,464.50

Services in execution of release from

Mortgage 150.00

Expenses in execution of release from

Mortgage 155.00 2,769.50

Services account safekeeping Sacramento

Northern Railroad Bonds 2,606.74

5,376.24

Irving Trust Company, New York, Trustee

The Western Pacific Railroad Company

General and Refunding Mortgage

Services as Trustee612.50

Expenses as Trustee208.64 821.14

Defendant's Exhibit No. 25—(Continued)

Fees and expenses of financial institutions as Trustees,
Agents, etc. (Cont.)

Services in execution of release from Mortgage	50.00		
Expenses in execution of release from Mortgage	29.32	79.32	900.46

Central Hanover Bank and Trust
Company, New York

Equipment Trust Series of 1937

Services as Trustee	225.00		
Services as Registrar	100.00		
Services account retirement of certificates	193.75		
Services paying interest	46.31	565.06	

Equipment Trust Series of 1941

Services as Trustee	235.00		
Services as Registrar	100.00		
Services account retirement of Certificates	331.25		
Services paying interest	46.38	712.63	1,277.69

Legal services and expenses, exclusive of services of General Counsel for Trustees and his office, and of services and expenses of the regular legal staff of the Company, as follows:

Fabian and Clendennin, Salt Lake City, Utah	Services	1,200.00	
	Expenses	.83	1,200.83
Morley, Griswold and Milton J. Reinhart, Elko, Nevada	Services	160.00	
	Expenses	36.32	196.32
Farnsworth and Van Cott, Salt Lake City, Utah	Services	51.00	
	Expenses	1.50	52.50
J. S. Halley, Reno, Nevada	Services		75.00
J. E. Robinson, Reno, Nevada	Services		100.00
George Lalise, Reno, Nevada	Services		50.00
S. C. Young, Quincy, California	Services	75.00	
	Expenses	23.81	98.81
Hinsdale, Otis, Johnson and Ware, Sacramento, California	Services	2,350.00	
	Expenses	133.62	2,483.62
Neumiller and Ditz, Stockton, California	Services	635.00	
	Expenses	117.98	752.98
Seth Milligan, Gridley, Calif.	Services		25.00

Defendant's Exhibit No. 25—(Continued)

Legal Services and Expenses, etc. (Cont.)

Jesse E. Nichols, Oakland, Calif.	Services	100.00	
	Expenses	14.00	114.00
Hynes, Browser and Ottonello, Oakland, California	Services		200.00
Brown, Rosson, and Gillis, Oakland, California	Services	2,935.00	
	Expenses	51.12	2,986.12
McCutcheon, Thomas, Matthew, Griffiths and Green, San Francisco	Expenses		220.17
Dunne and Dunne, San Francisco	Services	6,375.00	
	Expenses	167.34	6,542.34
Moran and Mielke, San Francisco	Services	750.00	
	Expenses	201.92	951.92
A. C. Wollenberg, San Francisco	Services	475.00	
	Expenses	39.00	514.00
Miscellaneous			2,087,921.13

Total Audited Vouchers\$35,127,996.71

Miscellaneous voucher payments include items of expenditure for the following, among various others:

Gasoline
Memberships in railroad, commercial and civic associations and organizations
Screws, nails, etc.
Postage, telephone, telegraph, electric light and power service and water service
Stationery and printing, blueprints, printers supplies, etc.
Hardware
Stockyard service charges at various points
Lighting supplies, electric supplies and materials
Locomotive repair parts ordinary
Car repair parts ordinary
Track fastenings ordinary
Frogs and switches ordinary
Paints, oils, varnishes and glass
Castings—Steel, iron, brass and bronze
Building materials and supplies
Sand and gravel
Payments to foreign lines (other than those hereinbefore specified for repairs to Western Pacific equipment)
Payments to other lines and terminals for switching
Advertising, miscellaneous
Freight pick-up and delivery service and drayage at various points
Pipe fittings ordinary
Auto supplies and parts
Explosives
Metals for various purposes
Car seals, and various other car and train supplies
Signal materials and supplies ordinary

Defendant's Exhibit No. 25—(Continued)

Furniture
Office Supplies
Services of various companies for checking and handling freight
Track motor cars and parts
Water pumps and parts
Dry goods
Rubber goods
Inspection of lumber, ties, rails and other materials
Repairs to miscellaneous buildings
Fire protection equipment
Freight charges on company material in freight forwarder's pool
shipments
Marine and ship chandlery supplies

Accounting Department
San Francisco, California

Defendants' Exhibit No. 25—(Continued)

EXHIBIT 2

T. M. Schumacher and S. M. Ehrman

Trustees in Reorganization

The Western Pacific Railroad Company—Debtor

Revenues, Expenses and Income

Period January 1, 1944, to December 31, 1944, Inclusive

Month	Total Railway Operating Revenues	Total Railway Operating Expenses	Tax Accruals	Hire of Equip- ment and Joint Facility Rents— Net Debit	Net Railway Operating Income	Other Income (Accruals)	Total Income (Accruals)	Miscellaneous Deductions From Income (Accruals)	Net Income
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
January	\$ 4,177,091.30	\$ 2,380,876.52	\$1,061,266.41	\$ 180,619.36	\$ 554,329.01	\$ 35,903.85	\$ 590,232.86	\$ 32,528.61	\$ 557,704.25
February	2,755,104.81	2,307,457.74	143,692.69	63,720.66	240,233.72	41,205.40	281,439.12	68,241.62	213,197.50
March	4,558,775.54	2,756,181.32	1,104,906.59	171,733.96	525,953.67	46,605.59	572,559.26	50,132.96	522,426.30
April	4,681,363.78	2,508,098.49	1,465,859.79	132,631.21	574,774.29	42,366.45	617,140.74	43,140.72	574,000.02
May	4,654,846.84	2,586,478.10	1,360,098.80	91,676.69	616,593.25	42,312.07	658,905.32	55,849.45	603,055.87
June	3,939,439.05	2,674,229.12	440,527.28	104,652.08	720,030.57	46,772.14	766,802.71	45,182.63	721,620.08
July	3,605,985.91	2,623,915.60	182,169.10	130,738.78	669,162.43	34,505.00	703,667.43	54,491.78	649,175.65
August	4,291,967.85	2,899,031.99	725,399.13	153,598.15	513,938.58	38,716.80	552,655.38	36,955.94	515,699.44
September	5,120,837.60	2,859,702.73	1,287,199.61	201,723.17	772,212.09	38,295.27	810,507.36	50,975.78	759,531.58
October	5,446,573.73	2,936,269.89	1,483,897.75	247,287.72	779,118.37	35,010.85	814,129.22	11,459.17	802,670.05
November	4,961,522.43	2,779,702.91	195,786.07	216,637.28	1,769,396.17	54,866.65	1,824,262.82	42,245.35	1,782,017.47
December	4,656,437.87	2,885,469.49	<i>1,088,328.78</i>	261,433.36	2,597,863.80	29,901.89	2,627,765.69	15,361.41	2,612,404.28
Jan. to Dec., Inclusive....	\$52,849,946.71	\$32,197,413.90	\$8,362,474.44	\$1,956,452.42	\$10,333,605.95	\$486,461.96	\$10,820,067.91	\$506,565.42	\$10,313,502.49

Note: Columns 8 and 9 exclude accruals for deductions from income for interest not being paid by Reorganization Trustees and amortization of discount on First Mortgage Bonds, as follows:

Month	Amount
January	\$ 275,282.91
February	274,335.31
March	275,282.93
April	274,809.10
May	275,282.92
June	274,809.27
July	275,282.92
August	275,282.94
September	274,809.09
October	275,282.92
November	274,809.10
December	275,283.09

Jan. to Dec.,
Inclusive\$3,300,552.50

Italics denote red figures.

Defendant's Exhibit No. 25—(Continued)

EXHIBIT No. 3

T. M. Schumacher and Sidney M. Ehrman,
Trustees in Reorganization of
The Western Pacific Railroad Company

Changes in Capital Accounts Due to Acquisitions of Property,
Improvements and Retirements as reported to the
Interstate Commerce Commission

Period January 1st, 1944, to December 31st, 1944

Year	Month	Acquisitions	Retirals	Net Additions
		Road and Equipment		
1944	January	\$ 395,918.14	\$ 4,969.20	\$ 390,948.94
1944	February	131,231.24	17,183.79	114,047.45
1944	March	226,630.35	35,042.50	191,587.85
1944	April	266,550.07	5,699.88	260,850.19
1944	May	209,179.63	7,425.63	201,754.00
1944	June	340,260.18	11,153.13	329,107.05
1944	July	1,737,506.09	20,870.87	1,716,635.22
1944	August	1,292,370.64	16,127.40	1,276,243.24
1944	September	215,981.78	30,967.46	185,014.32
1944	October	303,027.78	16,475.25	286,552.53
1944	November	795,855.66	79,621.41	716,234.25
1944	December	254,475.78	28,400.03	226,075.75
January 1st to December				
31st, 1944, Incl.		\$6,168,987.34	\$ 273,936.55	\$5,895,050.79

Defendant's Exhibit No. 25—(Continued)

Miscellaneous Physical Property

1944	January	.....\$	58.69	\$	.....	\$	58.69
1944	February	.....	2,662.74		<i>14,059.02</i>		<i>11,396.28</i>
1944	March	.....	22,576.04		.....		22,576.04
1944	April	.....	1,253.74		.....		1,253.74
1944	May	.....	3,241.87		.....		3,241.87
1944	June	.....	32,336.27		.....		32,336.27
1944	July	.....	11.24		.....		11.24
1944	August	.....	354.22		.....		354.22
1944	September	.....	6,838.60		.....		6,838.60
1944	October	.....	5,074.43		<i>1,008.51</i>		<i>4,065.92</i>
1944	November	.....	23,399.80		<i>500.00</i>		<i>22,899.80</i>
1944	December	.....	44.45		<i>3.29</i>		<i>41.16</i>
January 1st to December							
	31st, 1944, Incl.	.....\$	97,852.09	\$	<i>15,570.82</i>	\$	<i>82,281.27</i>

Italics denote red figures.

Investments in Affiliated Companies

Capital Stock

Year	Month	Acquisitions	Retirals	Net Additions
1944	April	.....\$ 300,000.00	\$	..... \$ 300,000.00
January 1st to December				
	31st, 1944, Incl.	.....\$ 300,000.00	\$	..... \$ 300,000.00

Notes

1944	November	.....\$	.....	\$	<i>508,278.61</i>	\$	<i>508,278.61</i>
January 1st to December							
	31st, 1944, Incl.	.....\$	.....	\$	<i>508,278.61</i>	\$	<i>508,278.61</i>

Advances

1944	January	.....\$	266.93	\$	<i>888.31</i>	\$	<i>621.38</i>
1944	February	.....	266.93		<i>23,925.25</i>		<i>23,658.32</i>
1944	March	.....	266.93		<i>230,000.00</i>		<i>229,733.07</i>
1944	April	.....	266.93		.....		266.93
1944	May	.....	266.93		.....		266.93
1944	June	.....	220,266.93		.....		220,266.93
1944	July	.....	266.93		.....		266.93
1944	August	.....	266.93		<i>198.89</i>		<i>68.04</i>
1944	September	.....	266.93		.....		266.93
1944	October	.....	266.93		<i>888.31</i>		<i>621.38</i>
1944	November	.....	266.93		.....		266.93
1944	December	.....	266.93		<i>303,310.86</i>		<i>303,043.93</i>
January 1st to December							
	31st, 1944, Incl.	.....\$	223,203.16	\$	<i>559,211.62</i>	\$	<i>336,008.46</i>
Total Investments in							
Affiliated Companies		.....\$	523,203.16	\$	<i>1,067,490.23</i>	\$	<i>544,287.07</i>

Defendant's Exhibit No. 25—(Continued)

Other Investments

Capital Stock

1944	October .....	\$	.....	\$	100.00	\$	100.00
<hr/>							
January 1st to December	31st, 1944, Incl. ....	\$	.....	\$	100.00	\$	100.00
<hr/>							

Notes

1944	June	\$	226.21	\$	.....	\$	226.21
1944	September		81.59				81.59
1944	November .....		.....		27.20		27.20
<hr/>							
January 1st to December	31st, 1944, Incl.	\$	307.80	\$	27.20	\$	280.60
<hr/>							
Total Other Investments		\$	307.80	\$	127.20	\$	180.60
<hr/> <hr/>							

Italics denote red figures.

Recapitulation

January to December, 1944, Inclusive

Year	Month	Acquisitions	Retirals	Net Additions
Total Acquisitions				\$6,790,350.39
Total Retirements				1,357,124.80
Grand Total—Net Additions.....				\$5,433,225.59
				<hr/> <hr/>

Italics denote red figures.

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANT'S EXHIBIT No. 26

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California.

Original Filed May 21, 1945, With Clerk, U. S.
Dist. Court, San Francisco.

In the District Court of the United States, for the
Northern District of California, Southern Di-
vision

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER APPROVING AND CONFIRMING
NINTH AND FINAL REPORT AND AC-
COUNTING BY THE TRUSTEES OF THE
PROPERTY OF THE DEBTOR, APPROV-
ING AND CONFIRMING THEIR ACTS
AND ACCOUNTS, DISCHARGING THEM
AS TRUSTEES AND EXONERATING
THEIR BONDS

The Ninth and Final Report and Accounting by
T. M. Schumacher and Sidney M. Ehrman, the
Trustees of the properties of the Debtor above
named, and the petition of said Trustees for ap-
proval of their acts and accounts, for their dis-
charge as Trustees and for the exoneration of their

Defendant's Exhibit No. 26—(Continued)

bonds, filed herein on April 30, 1945, came on regularly for hearing on May 21, 1945, and it appearing and the Court finding:

1. That said Trustees have given notice of hearing by mailing and publication as directed by the order of this Court made on April 30, 1945;

2. That the allegations of said Ninth and Final Report and Accounting and of said petition are true;

3. That as directed by the order of this Court made on November 27, 1944, and as requested by the Reorganization Committee, said Trustees executed, acknowledged and delivered to the Debtor Company, prior to December 28, 1944, a deed substantially in the form attached to said order as Exhibit "A," releasing and transferring to the Debtor Company as of 12:01 a.m., Pacific War Time, on December 29, 1944, title to all property, rights and interest of every kind and description held by them as such Trustees, thereupon and thereby divesting the Trustees of all title to all properties and assets held by them as Trustees in this proceeding and vesting such title to all thereof in the Debtor Company;

4. That in exchange for said deed, referred to in the immediately preceding paragraph hereof, said Trustees received from the Debtor Company an agreement, substantially in the form of Exhibit "D" attached to said order of November 27, 1944,

Defendant's Exhibit No. 26—(Continued)

whereby the Debtor Company assumed and agreed to perform all contracts, leases, agreements, liabilities and obligations of the Trustees remaining in effect on December 31, 1944;

5. That as authorized and directed by said order of this Court made on November 27, 1944, said Trustees continued their control and operation of the Debtor's business and properties until 12:00 o'clock midnight, Pacific War Time, on December 31, 1944, whereupon all possession, control and operation of said business and properties by the Trustees ceased and terminated, and possession, control and operation of all said business and properties were transferred to and accepted by the Debtor Company;

6. That at or prior to the end of the year 1944 said Trustees divested themselves of, and transferred and conveyed to and vested in the Debtor Company, all title to and all possession, control and operation of the business and properties theretofore held by the Trustees in this proceeding, all as required by orders of this Court; and

7. That all duties, obligations, services and responsibilities of said Trustees in this proceeding have been duly and fully performed and completed, save only the execution of any further instruments of conveyance, transfer, substitution or release which may be requested by the Debtor Company for the purpose of implementing or consummating the complete and effective transfer to the Debtor Com-

Defendant's Exhibit No. 26—(Continued)

pany of all of the business, properties, assets, contracts, agreements, leases, actions, rights and claims heretofore held by said Trustees in this proceeding.

Now, Therefore, the Court being fully advised in the premises, It Is Hereby Ordered, Adjudged and Decreed:

1. That said Ninth and Final Report and Accounting by said Trustees and all of their acts and accounts alleged and set forth in said Ninth and Final Report and Accounting be and the same are hereby approved and confirmed;

2. That said Trustees be, and they hereby are, discharged, reserving, however, to the Trustees, jointly and to each of them separately, and to the survivor of them, the power and authority hereafter to execute and deliver such instruments of conveyance, transfer, substitution or release as may be requested by the Debtor Company from time to time in order to implement, consummate, confirm or further evidence the complete and effective release, transfer and conveyance to the Debtor Company of all the business, properties, assets, contracts, agreements, leases, actions, rights and claims held by the Trustees in this proceeding; provided, however, that said Trustee shall have the right, but shall not be required, to submit any such instruments to this Court for approval prior to execution and delivery thereof, jurisdiction being hereby reserved by the Court for such purposes; and

Defendant's Exhibit No. 26—(Continued)

3. That notwithstanding their discharge said Trustees be, and they hereby are, authorized, jointly and separately, at any time upon the request of the Debtor Company, to cooperate with the Debtor Company in any and every suit, litigation, proceeding, controversy or compromise in which their cooperation as such Trustees may appear necessary or desirable; and

4. That the bonds heretofore given by said Trustees severally for the faithful discharge of their duties and responsibilities be, and the same hereby are, exonerated, and said Trustees and Fidelity and Deposit Company of Maryland, the surety upon each of said bonds, be and they hereby are released from all liability on said bonds.

Dated: May 21, 1945.

A. F. ST. SURE,
Judge.

[Endorsed]: Filed Feb. 11, 1949.

DEFENDANT'S EXHIBIT No. 28

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California.

Filed Feb. 1944

C. W. Calbreath, Clerk

(Original filed Feb. 21, 1944.

With Clerk, U. S. Dist. Court San Francisco.)

In the District Court of the United States, for the
Northern District of California, Southern Di-
vision

No. 26591-S

In the Matter of
THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER PROVIDING FOR HEARING UPON
PETITION FOR AUTHORITY TO ESTAB-
LISH RESERVE FUND FOR CONTIN-
GENT TAX LIABILITIES

Upon due consideration of the petition of T. M. Schumacher and Sidney M. Ehrman, Trustees of the properties of the Debtor above named, for authority to establish a reserve fund for contingent tax liabilities,

It Is Hereby Ordered as follows:

1. That said petition be and it hereby is set for

hearing before this Court on March 3, 1944, at 10 o'clock a.m.

2. That said Trustees be and they hereby are directed to give notice of the said hearing substantially in the following form:

Legal Notice

In the District Court of the United States, for the
Northern District of California, Southern Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAIROAD COMPANY,

Debtor.

Notice of Hearing Upon Petition for Authority to
Establish Reserve Fund for Contingent Tax
Liabilities

Notice Is Hereby Given, pursuant to the order of the above-named court, that a hearing will be held before the Honorable A. F. St. Sure, Judge of the above-entitled court, at the Court Room of the said Judge in the United States Post Office and Court House Building, Seventh and Mission Streets, in the City and County of San Francisco, State of California, on March 3, 1944, at 10 o'clock, a.m., upon the petition of T. M. Schumacher and Sidney M. Ehrman, Trustees in Reorganization of The Western Pacific Railroad Company, the Debtor above

named, for authority to establish a reserve fund for contingent tax liabilities.

T. M. SCHUMACHER and
SIDNEY M. EHRMAN,

Trustees in Reorganization of The Western Pacific
Railroad Company.

3. That the said notice be given by mailing prior to the 24th day of February, 1944, a copy of this order and a copy of said petition to the following parties:

1. Crocker First National Bank of San Francisco and Samuel Armstrong.

2. Irving Trust Company, as Trustee under Indenture securing Debtor's General and Refunding Mortgage Bonds.

3. A. C. James Co.

4. Reconstruction Finance Corporation.

5. The Railroad Credit Corporation.

6. The Chase National Bank of the City of New York, as Trustee under Agreement dated May 1, 1929, covering Equipment Trust Certificates.

7. The Western Pacific Railroad Corporation.

8. The Western Pacific Railroad Company.

9. The Western Realty Company.

10. Central Hanover Bank and Trust Company, as Trustee under Agreement dated February 1, 1937, covering Equipment Trust Certificates.

11. Central Hanover Bank and Trust Company,

1994 *Western Pacific R.R. Corp., et al., vs.*

as Trustee under Agreement dated August 1, 1941,
covering Equipment Trust Certificates.

Dated: February 21, 1944.

A. F. ST. SURE,
Judge.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANT'S EXHIBIT No. 29

M. C. Sloss,
Sloss, Turner & Finney,
1300, One Eleven Sutter,
San Francisco, California.

In the District Court of the United States, for the
Northern District of California, Southern Di-
vision

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

ORDER GRANTING PETITION OF INTER-
VENTION OF THE WESTERN PACIFIC
RAILROAD CORPORATION

The petition of The Western Pacific Railroad Corporation, a corporation, an unsecured creditor and the sole stockholder of the above-named debtor, filed herein on December 7, 1939, praying that it be

permitted to intervene for all purposes in the above-entitled proceeding, came on regularly this day for hearing.

The petitioner appeared and was represented by M. C. Sloss and Sloss, Turner & Finney, its counsel. No person appeared in opposition to said petition or made any objection to the granting of the same. Evidence, oral and documentary, was adduced in support of said petition from which it appeared and the Court finds that service of said petition and of notice of the time and place fixed for the hearing of the same by the order of this Court made and filed December 7, 1939, was made upon all persons named in said order, and in accordance therewith; that the allegations of said petition are true, and that good and sufficient cause exists for granting said petition and permitting the intervention sought thereby;

Wherefore, in consideration of the law and the premises, It Is Hereby Ordered that said petition be and the same is hereby granted; that said The Western Pacific Railroad Corporation be and it is hereby granted leave to intervene, for all purposes, in the above-entitled proceeding, and that it be and it is hereby admitted to said proceeding as and constituted a general party therein, with the right, as such party, to receive notice, to file notices, pleadings and other papers, to be heard by testimony or argument, and to take such other action in said proceeding as a party thereto, as it may deem proper,

1996 *Western Pacific R.R. Corp., et al., vs.*

but without prejudice to any action heretofore had or taken in said proceeding.

Dated: December 11, 1939.

A. F. ST. SURE,
United States District Judge.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 30

Original Filed Mar. 18, 1946.

With Clerk, U. S. Dist. Court, San Francisco.

In the District Court of the United States for the
Northern District of California, Southern Division

No. 26591-S

In the Matter of
THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

PETITION OF REORGANIZATION COMMITTEE FOR APPROVAL OF THEIR EXPENSES AND FOR A FINAL ORDER DISCHARGING THE COMMITTEE AND TERMINATING THE PROCEEDINGS

Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the members of the Reorganization Committee designated to put into effect and carry out the plan of reorganization of The Western

Defendants' Exhibit No. 30—(Continued)

Pacific Railroad Company, debtor above named, hereby represent to the Court and petition as follows:

1. The designation of Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, petitioners herein, as members of the Reorganization Committee of The Western Pacific Railroad Company, was approved by this Court by order entered October 11, 1943, confirming the plan of reorganization of said Company, and petitioners were directed to put into effect and carry out the plan of reorganization and the orders of the Court relative thereto under and subject to the supervision and control of the Court.

2. Pursuant to said order, petitioners, as such Reorganization Committee, proceed to carry out and put into effect the plan of reorganization under the supervision and control of the Court. By a report filed November 5, 1943, petitioners reported to the Court as to the selection of officers and counsel, designation of mailing address and adoption of by-laws for the Reorganization Committee; and by various petitions herein and testimony at hearings before the Court, petitioners have from time to time reported to the Court as to the various steps taken in carrying out and putting into effect the plan of reorganization.

3. By an order entered November 27, 1944, this Court fixed the date for the consummation of the plan of reorganization, directed the revesting of the

Defendants' Exhibit No. 30—(Continued)

properties of the debtor in The Western Pacific Railroad Company and authorized and directed the carrying out of the plan. Pursuant to the provisions of said order:

(a) The Certificate of Amendment to the Articles of Incorporation of The Western Pacific Railroad Company was, on December 22, 1944, filed with the Secretary of State of the State of California, and subsequently copies thereof were filed, as required by law, with the Secretaries of State of Nevada and Utah and in the several counties of the States of California, Nevada and Utah in which the railroad and properties of the debtor are located;

(b) T. M. Schumacher and Sidney M. Ehrman, Trustees in reorganization, continued their operation and control of the business and properties of the railroad company until twelve (12) o'clock midnight, December 31, 1944, and thereupon the control and operation of said business and properties by such Trustees ceased and The Western Pacific Railroad Company resumed the control and operation of its business and properties;

(c) T. M. Schumacher and Sidney M. Ehrman, Trustees in reorganization, executed, acknowledged and delivered to The Western Pacific Railroad Company the deed provided for in paragraph 4 of the order entered November 27, 1944;

(d) Crocker First National Bank of San Francisco and Samuel Armstrong, as Trustees under the First Mortgage, dated June 26, 1916, executed by The Western Pacific Railroad Company to First

Defendants' Exhibit No. 30—(Continued)

Federal Trust Company and Henry E. Cooper, Trustees (Crocker First National Bank of San Francisco and Samuel Armstrong, Successor Trustees), executed, acknowledged and delivered to The Western Pacific Railroad Company the deed of release and satisfaction of mortgage described in paragraph 5 of said order and performed all other acts directed to be performed by them in said paragraph 5;

(e) Irving Trust Company of New York, as Trustee under the General and Refunding Mortgage, executed by The Western Pacific Railroad Company February 29, 1932, as of January 1, 1932, to the Chase National Bank of the City of New York, Trustee (Irving Trust Company, Successor Trustee), executed, acknowledged and delivered to The Western Pacific Railroad Company the deed of release and satisfaction of mortgage described in paragraph 6 of said order and performed all other acts directed to be performed by them in said paragraph 6;

(f) The Western Pacific Railroad Company and its officers executed and delivered the Agreements and Indentures described in paragraph 8 of said order;

(g) The Western Pacific Railroad Company has assumed obligations and agreed to perform contracts, leases and agreements as provided in paragraph 9 of said order, and has made payments in various amounts of expenses and costs of administration of this proceeding, allowances, and other

Defendants' Exhibit No. 30—(Continued)
rentals, costs and expenses as provided in paragraph 10 of said order;

(h) The Western Pacific Railroad Company, on December 29, 1944, executed, issued and delivered, or caused to be made available for delivery, to the holders of the Company's existing First Mortgage Bonds and to the Company's secured creditors the new securities of the reorganized Company and made payments in cash to said bondholders and secured creditors, all in accordance with and as provided in paragraph 11 of said order;

(i) Pursuant to the provisions of paragraph 14 of said order, the Reorganization Committee caused to be prepared, published and mailed a notice to the holders of First Mortgage Bonds and secured notes of The Western Pacific Railroad Company, and in all other respects have put into effect and carried out the plan of reorganization and the orders of this Court relative thereto.

4. Pursuant to the arrangements made by the Reorganization Committee with Guaranty Trust Company of New York for the services of said Company as Depositary and Exchange Agent, and the letter of instructions from The Western Pacific Railroad Company relating to the deposit and exchange of securities (all as reported to this Court at a hearing on November 27, 1944) said Guaranty Trust Company of New York has made substantial and satisfactory progress in effecting the delivery and exchange of securities and the payment of cash, as directed in paragraph 11 of said order entered

Defendants' Exhibit No. 30—(Continued)

November 27, 1944, and will continue to act in carrying out such directions. Said Guaranty Trust Company of New York has reported to petitioners the securities and cash delivered and exchanged to the close of business on January 31, 1946, and the securities and cash remaining to be delivered. A copy of the report of said Guaranty Trust Company is annexed hereto as Exhibit "A."

5. The available net income of the debtor and its subsidiaries for the years 1939 to 1943, inclusive, as determined and found by this Court by order filed September 25, 1944, has been applied by The Western Pacific Railroad Company as directed in ordering paragraphs 5 and 6 of said order. Pursuant to ordering paragraph 17 of the order of this Court filed November 27, 1944, The Western Pacific Railroad Company has determined and applied the available net income of the Company for the calendar year 1944 in accordance with the provisions of subdivision L of the plan of reorganization and the provisions of said paragraph 17.

6. T. M. Schumacher and Sidney M. Ehrman, Trustees in reorganization, rendered their final account to this Court on April 30, 1945, and petitioned for their discharge and the release of their sureties. By order of this Court filed May 21, 1945, the accounts of said Trustees were approved, the Trustees were discharged and their sureties were exonerated and released.

7. Appeals were taken to the Circuit Court of

Defendants' Exhibit No. 30—(Continued)

Appeals for the Ninth Circuit by The Railroad Credit Corporation and by The Western Pacific Railroad Corporation from certain provisions of this Court's order filed September 14, 1944, construing the plan of reorganization in various respects and reconciling inconsistencies therein. Said appeals were argued on July 31, 1945, and on December 7, 1945, the rulings from which appeals were taken were affirmed by said Circuit Court of Appeals.

8. By order entered herein May 21, 1945, this Court made allowances of compensation to various parties in interest and their counsel (other than the Reorganization Committee and its counsel) and authorized and directed The Western Pacific Railroad Company to pay forthwith each and all of the allowances so made and said allowances were thereafter duly paid by said Company as directed in said order.

9. By order entered herein December 10, 1945, this Court made allowances to Whitman, Ransom, Coulson & Goetz, and to Pillsbury, Madison and Sutro, as counsel for the Reorganization Committee, and authorized and directed The Western Pacific Railroad Company to pay forthwith said allowances, and said allowances have been paid in full by said Company pursuant to said order.

10. By order filed herein October 23, 1944, this Court made an allowance in the aggregate amount of \$197,111.23 for certain expenses incurred and to be

Defendants' Exhibit No. 30—(Continued)

incurred in connection with the proceedings and plan of reorganization by the Reorganization Committee (exclusive of the fees and expenses of the Committee's counsel). Of said allowance, \$60,638.48 was ear-marked to provide for a contingent tax liability if payment thereof should be required, and \$136,472.75 was allowed for other expenses of the Reorganization Committee without limitation as to individual amounts with respect to component items. Said order also directed the Trustees of the debtor's estate to reimburse the Reorganization Committee and its officers and members out of the debtor's estate for certain expenses theretofore incurred by them in the aggregate amount of \$3,144.00, the detail of which was submitted to the Court upon the hearing, and provided that further payments of the actual and reasonable expenses of the Reorganization Committee (whether incurred before or after the date of said order) should be made out of the debtor's estate by the Trustees thereof so long as said Trustees were in control of the same, and thereafter by the reorganized company in accordance with the procedure directed in said order. Said order provided further that all further payments and advances to the Reorganization Committee under the provisions of the order should be subject to final approval and allowance by the Court at such time or times, or upon such showing as the Court may direct. There is submitted herewith and made a part hereof as Exhibit "B" a summary of the expenses of the Reorganization Committee, its officers and members, incurred in carrying out and

Defendants' Exhibit No. 30—(Continued)

putting into effect the plan of reorganization under the supervision and control of this Court (exclusive of the fees and expenses of the Committee's counsel). The detail of these expenses will be submitted at the hearing upon this petition. It is not anticipated that there will be any further expenses chargeable to the Committee, although provision should be made in the order upon this petition for such expenses and for the contingency of the assertion of the tax liabilities referred to above or other items not presently known. The expenses shown in Exhibit "B" were necessarily incurred by the Reorganization Committee, its officers and members, in carrying out and putting into effect the plan of reorganization and the Committee believes that said expenses were in every case reasonable in amount and within the allowance authorized by the order of this Court entered October 23, 1944.

Wherefore, your petitioners pray for an order of this Court

1. Determining that the plan of reorganization of The Western Pacific Railroad Company has been carried out and put into effect by petitioners as the Reorganization Committee in this proceeding in accordance with the provisions of the plan of reorganization and the orders and directions of this Court;

2. Approving and allowing the payments and advances to the Reorganization Committee as set forth in Exhibit "B" annexed hereto;

Defendants' Exhibit No. 30—(Continued)

3. Providing that The Western Pacific Railroad Company shall reimburse, indemnify and hold harmless the members of the Reorganization Committee, or any person employed by them, against any loss or expense arising out of or in connection with carrying out and putting into effect in good faith the plan of reorganization, including without limitation of the generality of said provision the contingent tax liability described in the order of the Interstate Commerce Commission of September 7, 1944, and allowed in the order of this Court entered October 23, 1944;

4. Discharging petitioners as members of the Reorganization Committee of The Western Pacific Railroad Company;

5. Terminating these proceedings, subject to such reservations of jurisdiction as may be appropriate, except as otherwise provided in the order of this Court entered May 21, 1945, discharging the Trustees in reorganization; and

6. Granting such other and further relief as may be proper in the premises.

Respectfully submitted,

FELIX T. SMITH,

PILLSBURY, MADISON AND
SUTRO.

WHITMAN, RANSOM,
COULSON & GOETZ,

Counsel for petitioners.

Defendants' Exhibit No. 30—(Continued)

State of New York,
County of New York—ss.

Robert E. Coulson, being duly sworn, deposes and says:

That he is a member of the Reorganization Committee of The Western Pacific Railroad Company; that he has read the foregoing petition and knows the contents thereof and that the same is true of his own knowledge, except as to the matters which are therein stated to be alleged on information and belief and that as to those matters he believes it to be true.

ROBERT E. COULSON.

Sworn to before me this 5th day of March, 1946.

/s/ BEATRICE C. CUNNINGHAM,
Notary Public,
New York County.

Commission expires March 30, 1946.

Defendants' Exhibit No. 30—(Continued)

EXHIBIT "A"

Report of Securities Surrendered, Securities Issued, Cash Disbursed and Securities to Be Surrendered and Securities and Cash to Be Disbursed Thereagainst, as of the Close of Business January 31, 1946, Under The Western Pacific Railroad Company Plan of Reorganization Effective as of January 1, 1939

Securities of The Western Pacific Railroad Company Issued and Cash Disbursed

Securities Surrendered	Principal Amount	Principal Amount of General Mtge. 4½% Income Bds. Ser. "A" Due 1/1/2014		Principal Amt. First Mtge. 4% Bonds Ser. "A" Due 1/1/1974		Shares of Pfd. Stk. Ser. "A"		Shares of Common Stock		Special Cash Payment	Cash Adjustment on Gen. Mtge. 4½% Income Bd. Ser. "A"	Cash Adjustment on Pfd. Stk. Ser. "A"	Cash Adjustment on Common Stock
		Fully Reg. Bonds	Bearer Serip	Full Shares	Bearer Serip 5ths	Full Shares	Bearer Serip 100ths	Full Shares	Bearer Serip 100ths				
The Western Pacific Railroad Company First Mortgage 5% Gold Bonds due March 1, 1946, Fully Reg. and with Cpn. due 3/1/34 and s/c/a or affidavit & indemnity agreement for missing coupons	\$48,802,000	\$19,512,900	\$ 7,900	292,735	385	227,149	756,340						
Ditto with Cpn. due 9/1/35 and s/c/a	10,000	4,000		60	33	560				\$4,392,180.00	900.00	\$4,629,357.87	\$2,051,148.21
Coupons due 3/1/34 and 9/1/34 detached from \$10,000 principal amount of The Western Pacific Railroad Company First Mtge. 5% Gold Bonds due 3/1/46	500				8	740						948.60	302.04
Claim of Reconstruction Finance Corporation													78.66
The Western Pacific Railroad Company 3% Certificates of Indebtedness due 12/1/1939	10,000,000												
The Western Pacific Railroad Company Notes													
due 3/ 1/35	699,000												
due 6/29/35	734,584												
due 8/ 1/35	136,045												
due 8/30/35	1,293,440												
due 3/25/36	99,931												
The Western Pacific Railroad Company Gen. & Ref. Mtge. Bonds Ser. "A" dated 1/1/32 due 1/1/57	8,750,000												
The Western Pacific Railroad Company Gen. & Ref. Mtge. Bonds Ser. "B" dated 7/1/32 due 1/1/57	2,000,000	1,185,200		\$10,000,000	17,778	15,788				266,670.00		281,070.18	142,092.00
Claim of the Railroad Credit Corporation													
The Western Pacific Railroad Company Notes													
due 2/28/34	1,303,000												
due 5/24/35	1,293,439												
The Western Pacific Railroad Company Gen. & Ref. Mtge. Bonds Ser. "A" dated 1/1/32 due 1/1/57	2,000,000												
The Western Pacific Railroad Company Gen. & Ref. Mtge. Bonds Ser. "B" dated 7/1/32 due 1/1/57	2,000,000	154,000	80.00	2,416	2	34,988				\$ 72.00	34,668.00	38,203.28	314,892.00
Claim of A. C. James Company													
The Western Pacific Railroad Company Notes													
due 3/28/35	4,504,000												
due 3/28/35	347,000												
due 5/31/35	148,800												
The Western Pacific Railroad Company Gen. & Ref. Mtge. Bds. Ser. "A" dated 1/1/32 due 1/1/57	4,249,500	163,600	80.00	2,567		37,635				100.00	36,828.00	40,584.27	338,715.00
Refund to the Company on 4,400 shs. of common stock which will not be issued													39.60
Total		\$21,019,700	\$8,060.00	\$10,000,000	315,556	387	315,601	757,640	\$172.00	\$4,731,246.00	\$4,990,164.20	\$2,847,267.51	

Defendants' Exhibit No. 30—(Continued)

State of New York,
County of New York—ss.

Robert E. Coulson, being duly sworn, deposes and says:

That he is a member of the Reorganization Committee of The Western Pacific Railroad Company; that he has read the foregoing petition and knows the contents thereof and that the same is true of his own knowledge, except as to the matters which are therein stated to be alleged on information and belief and that as to those matters he believes it to be true.

ROBERT E. COULSON.

Sworn to before me this 5th day of March, 1946.

/s/ BEATRICE C. CUNNINGHAM,
Notary Public,
New York County.

Commission expires March 30, 1946.

Defendants' Exhibit No. 30—(Continued)

EXHIBIT "A"—(Continued)

Payment of Interest and Dividends on the Western Pacific Railroad Company Securities Issued

Interest Due for the Year 1944 on General Mtge. 4½% Income Bonds Ser. "A" Due 1/1/2014		Dividends on Preferred Stock Series "A"		Dividends on Common Stock	
Paid on Bonds issued on exchanges	\$5,836.50	Paid on Full Shares of Stock issued on exchanges	\$4,110.00	Paid on Full Shares of Stock issued on exchanges	\$1,828.50
Paid to City Bank Farmers Trust Com- pany for Interest on Bonds represented by Outstanding Scrip	148.50	Paid to City Bank Farmers Trust Com- pany for dividends on Full Shares represented by Outstanding Scrip	133.75	Paid to City Bank Farmers Trust Com- pany for Dividend on Full Shares rep- resented by Outstanding Scrip	756.75
				Paid to Company for Dividend on 4,400 shares which will not be issued	6.60
Total	\$5,985.00		\$4,243.75		\$2,591.85

The Western Pacific Railroad Company Securities and Cash to Be Disbursed

Securities to Be Surrendered	Principal Amount	Principal Amount of 4½% General Mtge. Income Gold Bonds Ser. "A" Due 1/1/2014	Shares of Pfd. Stk. Ser. "A"	Shares of Common Stock	Cash Adjustment on Gen. Mtge. 4½% Income Gold Bds. Ser. "A" Due 1/1/2014	Cash Adjustment on Preferred Stock Ser. "A"	Cash Adjustment on Common Stock
The Western Pacific Railroad Company 1st Mtge. 5% Gold Bonds due 3/1/46	(Approximately) (9/10ths of 1%) (which percentage) (applies to the) (securities to) (be issued) \$478,100	\$191,240	2,868-6/10ths	2,232-727/1000ths	\$43,029.00	\$45,352.42	\$20,094.39
To be delivered to The Railroad Credit Corporation				437			3,933.00
Total		\$191,240	2,868-6/10ths	2,669-727/1000ths	\$43,029.00	\$45,352.42	\$24,027.39
		Interest to Be Disbursed on General Mtge. 4½% Income Gold Bonds Ser. "A" Due 1/1/2014 (*)\$8,685.00	Dividends to Be Disbursed on Preferred Stock Series "A" (*)\$10,770.00		Dividends to Be Disbursed on Common Stock (*)\$6,053.32		

(*) These balances include funds which are to be paid to City Bank Farmers Trust Company, scrip agent, on bonds, full shares of Preferred Stock, Series "A" and Common Stock issued by them against the combination of scrip certificates.

Defendants' Exhibit No. 30—(Continued)

EXHIBIT "B"

The Western Pacific Railroad Company
Summary of Expenses of
Reorganization Committee

	Amounts Estimated	Amounts Paid to Date
1. Charges and expenses of Trustees, Registrar and other agents in connection with issuance and exchange of securities	\$ 36,625.00	\$25,515.46
2. Charges of Trustees, Registrar and other agents in connection with exchange of temporary securities for definitives	19,700.00	9,536.57
3. Charges and expenses of Trustees under previously existing mortgages	11,564.50	6,677.59
4. Statutory fees in connection with mortgages	3,500.00	2,715.66
5. Statutory fees in connection with amendment of articles of incorporation	962.50	12.45
6. Stock Exchanges' listing fees	13,350.00	12,834.00
7. Cost of engraving and printing new securities	14,470.75	8,182.31
8. Cost of printing new mortgages, Reorganization Committee record and other documents	6,500.00	15,605.96
9. Traveling and other expenses of Reorganization Committee and their agents (other than Counsel)	8,000.00	3,834.16
10. Miscellaneous	21,800.00	2,664.68
Total, exclusive of amount for contingent tax liabilities	\$136,472.75	\$87,578.84
11. Amount for contingent tax liabilities	60,838.48	
Total authorization under Court Order filed October 23, 1944	\$197,111.23	

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 31

Original filed Mar. 18, 1946,

With Clerk, U. S. Dist. Court, San Francisco.

In the District Court of the United States for the
Northern District of California, Southern Division.

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

ORDER PROVIDING FOR HEARING UPON
PETITION OF REORGANIZATION COMMITTEE FOR APPROVAL OF THEIR EXPENSES AND FOR A FINAL ORDER DISCHARGING THE COMMITTEE AND TERMINATING THE PROCEEDINGS

Upon due consideration of the petition of Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the duly constituted Reorganization Committee designated to carry out the plan of reorganization of The Western Pacific Railroad Company, for an order approving their expenses, discharging the Committee and terminating the proceedings,

It Is Hereby Ordered as follows:

1. That said petition be and it hereby is set for hearing before this Court on March 28, 1946, at 10 o'clock a. m.

2. That said Reorganization Committee be and they hereby are directed to give notice of the said hearing substantially in the following form:

Legal Notice

In the District Court of the United States for the Northern District of California, Southern Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

NOTICE OF HEARING UPON PETITION OF REORGANIZATION COMMITTEE FOR APPROVAL OF THEIR EXPENSES AND FOR A FINAL ORDER DISCHARGING THE COMMITTEE AND TERMINATING THE PROCEEDINGS

Notice Is Hereby Given, pursuant to the order of the above-named Court, that a hearing will be held before the Honorable A. F. St. Sure, Judge of the above-entitled Court, at the Court Room of the Court House Building, Seventh and Mission Streets, in the City and County of San Francisco, State of California, on March 28, 1946, at 10 o'clock a.m. upon the petition of Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the duly constituted Reorganization Committee designated to carry out the plan of reorganization of The Western

Pacific Railroad Company, for approval of their expenses and for a final order discharging the Committee and terminating the proceedings.

Whitman, Ransom, Coulson & Goetz
Counsel for the Reorganization Committee
of
The Western Pacific Railroad Company

3. That the said notice be given by mailing or delivering prior to the 20th day of March, 1946, a copy of this order and copy of said petition, together with copies of the Exhibits submitted therewith, to the following parties:

1. Crocker First National Bank of San Francisco and Samuel Armstrong.
2. Irving Trust Company.
3. A. C. James Co.
4. Reconstruction Finance Corporation.
5. The Railroad Credit Corporation.
6. The Chase National Bank of the City of New York.
7. The Western Pacific Railroad Corporation.
8. The Western Pacific Railroad Company.
9. The Western Realty Company.
10. Allan P. Matthew, as counsel for the Reorganization Trustees.

11. The Institutional Bondholders Committee
(Cravath, Swaine & Moore, counsel).

12. T. M. Schumacher, Esq.

13. Sidney M. Ehrman, Esq.

14. Guaranty Trust Company of New York.

Dated, March 18, 1946.

/s/ A. F. ST. SURE.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 32

Original Filed Mar. 28, 1946.

With Clerk, U. S. Dist. Court, San Francisco.

In the District Court of the United States for the
Northern District of California, Southern Di-
vision.

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD
COMPANY,

Debtor.

FINAL ORDER

The petition filed March 18, 1946, by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the duly constituted Reorganization Committee designated to carry out the plan of reorganization of The Western Pacific Railroad Company above

Defendants' Exhibit No. 32—(Continued)

named, for an order approving their expenses, discharging the Committee and terminating the proceedings duly came on to be heard on March 28, 1946, and was heard and has been submitted.

The Court being fully advised in the premises finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court dated and filed March 18, 1946, and that all of the allegations and representations contained in the petition are true. The Court further finds and concludes:

(a) All of the business, assets and property constituting the debtor's estate of every kind and character, real, personal and mixed, and all of the right, title and interest therein of T. M. Schumacher and Sidney M. Ehrman, as Trustees in Reorganization, vested in and became the absolute property of The Western Pacific Railroad Company on December 29, 1944, free and clear of all rights, claims, interests, liens and encumbrances of the former stockholders and creditors of the debtor company and all other persons, except as otherwise provided and directed in the order of this Court in this proceeding dated and entered November 27, 1944; and The Western Pacific Railroad Company is released and discharged forever from all of its debts and liabilities existing on or before December 28, 1944, whether or not the same have been presented and allowed in these proceedings, and said reorganized Company is free and clear of all such rights, claims, interests, liens, encumbrances, debts, obligations and

Defendants' Exhibit No. 32—(Continued)

liabilities, except as otherwise expressly provided in said order.

(b) The plan of reorganiaztion of The Western Pacific Railroad Company, which was duly confirmed by order of this Court dated and entered October 11, 1943, has been fully and properly carried out and put into effect in accordance with the terms and provisions of said plan and the orders of this Court heretofore entered in this proceeding; all acts and things required by the order of this Court dated and entered November 27, 1944, to be done or performed in order to consummate said plan, have been properly done or performed; the exchange of more than 99% of the principal amount of securities of the reorganized company has been effected in accordance with the plan of reorganization and the orders of this Court; and adequate and proper arrangements have been made for the exchange of the remainder of said securities.

(c) The reasonable and necessary expenses of the Reorganization Committee in carrying out and putting into effect the plan of reorganization, as disclosed by Schedule "B" annexed to the petition for this order, filed by said Committee and supported by evidence introduced at the hearing upon said petition, exclusive of the fees and expenses of the attorneys for said Committee, which have heretofore been approved and allowed by order of this Court filed December 10, 1945, are within the maximum limits approved by the Interstate Commerce

Defendants' Exhibit No. 32—(Continued)

Commission and authorized by this Court by order filed October 23, 1944, and should be finally approved and allowed.

(d) Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, members of the duly constituted Reorganization Committee, have fulfilled their functions, faithfully performed their duties as members of the Reorganization Committee and now have no further duties and should be discharged.

(e) The plan of reorganization having been carried out and put into effect in accordance with the terms of the plan and the orders of this Court, a final decree should be entered in this cause, subject only to the reservations of the jurisdiction hereinafter made in this decree.

Now, Therefore, it is hereby Ordered, Adjudged and Decreed:

1. That these proceedings be and they hereby are terminated subject only to the reservations of jurisdiction hereinafter made by the Court in this order, and the reservations of jurisdiction contained in the order of this Court discharging the Trustees of the Debtor's estate, dated and entered May 21, 1945.

2. That the expenses incurred by the Reorganization Committee in consummating, carrying out and putting into effect the plan of reorganization, as shown by the summary which is attached as Exhibit "B" to the petition for this order, filed by the Reorganization Committee, are hereby in all respects finally approved and allowed.

Defendants' Exhibit No. 32—(Continued)

3. That the actions of the Reorganization Committee in putting into effect and carrying out the plan of reorganization and the orders and directions of this Court relative thereto, are hereby approved, ratified and confirmed.

4. That Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the members of the Reorganization Committee herein, be and each of them is hereby discharged and relieved from all further duties herein.

5. That the order of this Court dated and entered November 27, 1944, in this proceeding shall remain in full force and effect in so far as said order has not been fully carried out.

6. All persons, firms, and corporations whatsoever, and wheresoever situated, located or domiciled, are hereby perpetually restrained and enjoined from instituting, prosecuting, or pursuing, or attempting to institute, prosecute or pursue, any suit or suits or proceedings in law or in equity, or otherwise, against The Western Pacific Railroad Company, or against the successors or assigns of said Company, or against any of the assets or property of said Company or its successors or assigns, directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before Decem-

Defendants' Exhibit No. 32—(Continued)

ber 28, 1944 (except as specifically provided for or permitted by prior order of this Court), and from interfering with, attaching, garnishing, levying upon, enforcing liens against or upon, or in any manner whatsoever disturbing any portion of the property, real, personal, or mixed, of any kind or character, now or hereafter belonging to or being in the possession of said Company, and from interfering with or taking steps to interfere with said Company, its officers and agents, or the operation of the lines of railroad or properties or the conduct of the business of said Company, by reason or on account of any obligation or obligations incurred by the Debtor or by the Trustees of the Debtor's estate on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), and all such persons, firms and corporations are also hereby restrained and enjoined from prosecuting against the Reorganization Committee, or any of them, their agents or attorneys, or against the Trustees of the Debtor's estate, or either of them, their agents or attorneys, or against the said Company, its agents or attorneys, any suit or proceeding arising out of, or based on, any act or acts done or omitted to be done in putting into effect and carrying out the plan of reorganization or any order of this Court entered in these proceedings.

7. The Western Pacific Railroad Company is hereby ordered and directed to reimburse, indemnify

Defendants' Exhibit No. 32—(Continued)

and hold harmless the members of the Reorganization Committee, or any of them, or any person employed by them, against any loss or expense arising out of or in connection with carrying out and putting into effect in good faith the plan of reorganization, including, without limitation of the generality of the foregoing, the contingent tax liability described in the order of the Interstate Commerce Commission of September 7, 1944, and allowed in the order of this Court entered October 23, 1944.

8. The Western Pacific Railroad Company is hereby directed to give notice of the entry of this final order by mailing, postage prepaid, a copy of this order to the Trustees of the debtor's estate, the Reorganization Committee, each party of record in the reorganization proceedings before this Court or the Interstate Commerce Commission (or the counsel for each such party), and to cause promptly to be published a notice of the entry of this final order, setting forth in said notice the complete text of this order as certified by the clerk of this Court, such publication to be made once in each of the following: A daily newspaper of general circulation in the City of San Francisco, California; a daily newspaper of general circulation in the City of New York, New York; and a daily newspaper of general circulation in the City of Chicago, Illinois. Proof of such service and publication shall be filed by said Company with the Clerk of this

Defendants' Exhibit No. 32—(Continued)

Court within thirty days after the completion of the same.

9. The Court hereby reserves jurisdiction to take such further proceedings as may be proper or necessary to enforce and make effective any direction or other provision contained in the order of this Court, filed November 27, 1944, in this proceeding, to enforce and make effective the terms and provisions of this final decree and, if necessary, to give instructions to the Western Pacific Railroad Company, upon application by said Company, with respect to carrying out the provisions of said order filed November 27, 1944, in this proceeding, to ensuch further proceedings as may be proper or necessary in connection with any appeal or appeals prosecuted from any order of this Court, in this proceeding; and to take such further proceedings as may be necessary or proper in connection with any expenses or liabilities within the provisions of the order of this Court filed October 23, 1944, or otherwise, which may hereafter be asserted against the Reorganization Committee, its agents or attorneys, in connection with carrying out and putting into effect the plan of reorganization.

10. Except as hereby specifically provided in the reservations of jurisdiction set forth in Paragraph 9 above, and except as provided in the reservations of jurisdiction of the order of this Court filed May 21, 1945, discharging the Trustees of the debtor's estate, the reorganization proceedings in

Defendants' Exhibit No. 32—(Continued)
this Court, entitled in the Matter of the Western Pacific Railroad Company, Debtor, No. 26591-S, are hereby terminated and the case is closed.

Dated: March 28, 1946.

A. F. ST. SURE,
District Judge.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 33

Reorganization Plan
of

The Western Pacific Railroad Company
(233 I.C.C. 409)

"P. The existing securities of the debtor shall be treated as follows:

* * *

5. The A. C. James Company shall receive in respect of its claim in the principal amount of \$4,999,800, together with \$1,249,950 of the interest accrued and unpaid thereon to January 1, 1939, \$163,724 of income-mortgage 4½-percent bonds, series A; \$256,756 of 5-percent preferred stock, series A; and 37,635 shares of common stock, being an amount of common stock which bears to the amount of common stock allotted to the claim of the Railroad Credit Corporation the same proportion that the principal amount of general and re-

funding mortgage bonds of the debtor held by the A. C. James Company as collateral for said claim, bears to the principal amount of such bonds held by the Railroad Credit Corporation as collateral for its claim.”

(233 I.C.C. at 452)

Summary of result of foregoing treatment of A. C. James Company's claim:

Amount of Claim:

Principal	\$4,999,800
Interest to January 1, 1939	1,249,950

Total Claim	<u>\$6,249,750</u>
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Securities received:

Income Bonds	\$ 163,724
Preferred Stock (at par)	256,756
Common Stock (37,635 shares at \$62)*	<u>2,333,370</u>

Total Receipts	<u>2,753,850</u>
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Deficiency	<u><u>\$3,495,900</u></u>
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* The price the Commission used in allocating common stock to Railroad Credit Corporation on account of its claim.

. [Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 34

Memorandum for Mr. Matthew

From Mr. Enersen

March 1, 1944

For Hearing March 3d

The Western Pacific Railroad Company
Reorganization

Contingent Tax Liability Reserve Fund

Memorandum for Hearing

March 3, 1944

Statement to the Court

1. Notice: Notice has been given as required by the order for hearing and an affidavit to that effect is on file.

2. Subject Matter: By this petition the Trustees seek authority to establish a contingent tax liability reserve fund in the amount of \$7,100,000 to provide for the payment of any Federal income and excess profits tax liability which may be found due for the taxable year 1943.

3. Explanatory Statement: If the operations of the railroad of the Debtor should be subject to Federal income and excess profits taxes without regard to the income or loss of the affiliated corporations, the tax liability for 1943 would be approximately \$7,000,000. For several years, however, consolidated Federal income and excess profits tax returns have been filed covering the operations of the railroad of the Debtor and the operations of

Defendants' Exhibit No. 34—(Continued)

all of the affiliated corporations, including The Western Pacific Railroad Corporation, the owner of all of the capital stock of the Debtor Company. During the taxable year 1943 certain of the affiliated corporations had very substantial net losses which more than offset the net income of the Debtor company. The largest net loss was that of the Western Pacific Railroad Corporation and its net loss was primarily attributable to the fact that upon confirmation of the plan of reorganization of the Debtor company the Debtor's corporate stock owned by the holding company became valueless. The Trustees have been advised by their accountants and tax counsel that there is no Federal income or excess profits tax due for the year 1943. However, the accountants and tax advisers have also stated that in view of the substantial amount involved the Commissioner of Internal Revenue may dispute their conclusions, with the result that there may be litigation regarding the matter. The Trustees believe that it is prudent to establish a funded reserve adequate to provide for the payment of the maximum possible tax which may be found to be due.

I desire to call Mr. Elsey to testify regarding this matter.

Testimony

1. What would be the maximum Federal income and excess profits tax liability for the Company if it filed a separate return for the year 1943, accord-

Defendants' Exhibit No. 34—(Continued)

ing to the computations of the Company's accountants and tax advisers?

Approximately \$7,000,000.

2. Please explain to the Court the reason why it is believed no tax will be due under the consolidated return method of reporting the income and losses of the several affiliated corporations.

Consolidated returns have been filed by the debtor company and its affiliated corporations for several years, as permitted by the Federal income and excess profits tax laws. During the calendar year 1943 certain members of the group sustained very substantial losses, particularly The Western Pacific Railroad Corporation. That company sustained a very large loss when the stock of the debtor company owned by it became valueless upon confirmation of the Western Pacific reorganization plan in 1943. The aggregate net losses of the affiliated corporations for the year 1943 more than offset the net income of the debtor company for the same year. According to our advisers no tax is due for 1943 for that reason.

3. Do you believe, however, that it is prudent to establish a funded reserve to provide for the payment of any tax which may ultimately be found due?

Yes, I believe a funded reserve should be established for this purpose. Tax questions are seldom free from doubt. While we are confident

Defendants' Exhibit No. 34—(Continued)

of our conclusion in this instance, nevertheless, in view of the substantial amount here involved, the Internal Revenue Bureau may desire to litigate the matter. I think the debtor company should set aside out of 1943 earnings a sufficient amount so that it will be able to pay the highest possible tax which might conceivably be found due if the Commissioner should prevail in such litigation.

4. What is the attitude of the Trustees about the matter?

They have approved my recommendation that we establish a funded reserve of \$7,100,000 out of 1943 earnings of the railroad of the Debtor.

5. How do you believe that the fund should be held?

I should think that it ought to be invested in United States Treasury securities.

Concluding Statement

The Trustees are asking for an order authorizing the establishment of this reserve fund out of 1943 earnings of the railroad, the fund to be invested in United States Treasury securities. Counsel for the First Mortgage Trustees and counsel for the Reorganization Committee are present in Court and I believe they are prepared to state the position of their respective principals upon this matter.

B. E.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. ~~15~~ 35-A

Western Union

Telegram Form

1944, Jan. 9 AM 10 47

CDU264 CAK=CD NewYork NY 29 12 1P

Charles Elsey

Western Pacific Railroad Co

526 Mission St SFran

Letter twenty-fourth, telegram twenty-eighth, regarding federal tax matter. Very interesting. I approve making appropriate entries on books in December and your proposap create contingency fund and its investment in government securities and you are authorized instruct Matthew file petition with court for formal approval.

T M SCHIMACHER.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 35-B

Heller, Ehrman, White & McAuliffe

Attorneys and Counselors at Law

Nevada Bank Building

San Francisco

Subject: Your file 073

January 26, 1944

Mr. Charles Elsey

The Western Pacific Railroad Company

526 Mission Street

San Francisco, 5

Dear Mr. Elsey:

In reply to your letter of January 24, 1944, num-

bered as above, my approval is extended to the creation of a contingent fund and its investment in securities of the United States to provide for any possible adverse ruling on federal income taxes for the year 1943, such fund to be held until a final determination of the question in issue. If Mr. Schumacher concurs kindly instruct Mr. Matthew to obtain an order of court giving us authority in the matter.

Yours very truly

/s/ SIDNEY M. ERHMAN.

cc Mr. Allan P. Matthew

cc Mr. T. M. Schumacher

[Stamped]: The Western Pacific Railroad Co.
President—Jan. 28, 1944.

[Endorsed]: Filed Feb. 15, 1949.

DEFENDANTS' EXHIBIT No. 37-A

At 40 Wall Street
New York 5, N. Y.

September 27, 1946

Messrs. Whitman, Ransom, Coulson & Goetz
40 Wall Street
New York 5, N. Y.

Gentlemen:

In order to protect any equitable interests that The Western Pacific Railroad Corporation may have in the reserves set up by The Western Pacific

Railroad Company on account of tax deductions, as well as in any refunds of tax payments arising from claims filed by the Corporation, we propose to file a Bill of Complaint in the District Court of the United States, for the Northern District of California, Southern Division, asking that these reserves and refunds, if any, be impounded pending an accounting and an equitable determination to ascertain what, if any, interests the Corporation may have therein.

Appreciating that your firm has acted as tax counsel for both the Company and the Corporation in the filing of Consolidated Tax Returns and in the proceedings now pending before the Internal Revenue Department, we would, of course, not wish to take any steps which would in any way prejudice the claims made in these returns. We would therefore appreciate your advice on this, and would be glad to have any suggestions you may make for the full protection of the interests of the Corporation therein.

I would be glad to arrange a conference between your Mr. Polk and our counsel to discuss this matter further.

Yours very truly,

.....

President.

[Endorsed]: Filed Feb. 17, 1949.

DEFENDANTS' EXHIBIT No. 37B

The Western Pacific Railroad Corporation
51st Floor 40 Wall Street
New York 5, N. Y.

Mr. F. C. Nicodemus, Jr.
40 Wall Street
New York 5, N. Y.

Mr. A. Perry Osborn
20 Exchange Place
New York 5, N. Y.

Gentlemen:

Herewith, for your information, is copy of reply from Mr. James K. Polk of the firm of Whitman, Ransom, Coulson & Goetz, to my letter of September 27, 1946, copy of which was sent to you, relative filing of claim against The Western Pacific Railroad Company and its subsidiaries for participation in federal tax benefits for the years 1942, 1943 and the first four months of 1944.

Yours very truly,

/s/ M. J. CURRY.

Enclosure

[Endorsed]: Filed Feb. 17, 1949.

DEFENDANTS' EXHIBIT No. 37-C

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York
(Copy)

October 4, 1946

Mr. M. J. Curry, President
The Western Pacific Railroad Corporation
40 Wall Street
New York 5, N. Y.

Dear Sir:

This refers to your letter of September 27, 1946, addressed to this firm. The undersigned has been acting as tax counsel in connection with pending tax questions arising under Federal consolidated returns made by the Western Pacific group for the period ended April 30, 1944, and prior open years. In presenting the issues as to these tax matters to the Treasury Department it will be necessary to develop the facts fully and the Treasury Department is clearly entitled to any relevant information. There would, therefore, seem to be no reason why any development of facts in a separate litigation instituted by your Company in the United States District Court in California would present necessary embarrassment in connection with the tax questions.

Very truly yours,

JAMES K. POLK.

[Endorsed]: Filed Feb. 17, 1949.

DEFENDANTS' EXHIBIT No. 41

The Western Pacific Railroad Company

Federal income and excess profits taxes for years 1942 and 1943 and the first four months of 1944 on the basis of assuming that The Western Pacific Railroad Company had filed separate returns and had the benefit of its own net operating loss carry-overs and excess profits credit carry-overs (computed as though it had filed separate returns in prior years) and the additional deductions from income as shown in the note below

Period	Income tax	Excess profits tax	Total
1942	\$3,331,638.25		\$3,331,638.25
1943	3,136,913.38		3,136,913.38
First four months of 1944.....	558,078.49	\$702,478.26	1,260,556.75
	<u>\$7,026,630.12</u>	<u>\$702,478.26</u>	<u>\$7,729,108.38</u>
Income tax for 1942 allocated on consolidated return			4,144,828.87
Difference.....			<u><u>\$3,584,279.51</u></u>

Notes:

(1) The computations of the taxes tabulated above are based on the returns filed. However, the computations give effect to correction of certain errors (immaterial in the returns as filed) and to Revenue Agent's conclusions contained in reports dated June 12, 1947, covering examination of the years 1940 and 1941. The computations also give effect to the following deductions for the years indicated, which were not claimed in the returns filed:—

	1941	1942	1943	First four months of 1944
Accelerated amortization				
United States Government freight cutbacks and refunds	\$50,000.00	\$127,531.24	\$ 259,654.81	\$522,741.10
Partial bad debt loss on Sacramento Northern Railway notes and advances		780,000.00	1,060,000.00	40,000.00
			8,526,690.72	

(2) No excess profits taxes were allocated on consolidated returns.

No (declared value) excess-profits taxes were paid during the period.

February 16, 1949

[Endorsed]: Feb. 17, 1949.

DEFENDANTS' EXHIBIT No. 43

The Western Pacific Railroad Company

Federal income and excess profits taxes for years 1942 and 1943 and the first four months of 1944 on the basis of assuming that The Western Pacific Railroad Company had filed separate returns and had the benefit of its own net operating loss carry-overs and excess profits credit carry-overs (computed as though it had filed separate returns in prior years) and the additional deductions from income as shown in the note below

Period	Income tax	Excess profits tax	Total
1942	\$3,179,638.25		\$3,179,638.25
1943	2,932,913.38		2,932,913.38
First four months of 1944.....	558,078.49	\$693,928.26	1,252,006.75
	<u>\$6,670,630.12</u>	<u>\$693,928.26</u>	<u>\$7,364,558.38</u>
Income tax for 1942 allocated on consolidated return			4,144,828.87
Difference.....			<u>\$3,219,729.51</u>

Notes:

(1) The computations of the taxes tabulated above are based on the returns filed. However, the computations give effect to correction of certain errors (immaterial in the returns as filed) and to Revenue Agent's conclusions contained in reports dated June 12, 1947, covering examination of the years 1940 and 1941. The computations also give effect to the following deductions for the years indicated, which were not claimed in the returns filed:—

	1941	1942	1943	First four months of 1944
Accelerated amortization				
United States Government freight cutbacks and refunds	\$80,000.00	\$ 127,531.24	\$ 259,654.81	\$522,741.10
Partial bad debt loss on Sacramento Northern Railway notes and advances		1,160,000.00	1,570,000.00	50,000.00
			8,526,690.72	

(2) No excess profits taxes were allocated on consolidated returns.

No (declared value) excess-profits taxes were paid during the period.

February 16, 1949

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 44

The Western Pacific Railroad Company

Federal income taxes for years 1942 and 1943 and the first four months of 1944 on the basis of assuming that The Western Pacific Railroad Company had filed separate returns and had the benefit of its own net operating loss carry-overs and excess profits credit carry-overs (computed as though it had filed separate returns in prior years) and the additional deductions from income as shown in the note below

Tax

Period

1942	\$2,895,638.25
1943	2,120,913.38
First four months of 1944	522,723.30
	<hr/>
Income tax for 1942 allocated on consolidated return	\$5,539,274.93
	4,144,828.87
Difference.....	<hr/>
	\$1,394,446.06
	<hr/>

Notes:

(1) The computations of the taxes tabulated above are based on the returns filed. However, the computations give effect to correction of certain errors (immaterial in the returns as filed) and to Revenue Agent's conclusions contained in reports dated June 12, 1947, covering examination of the years 1940 and 1941. The computations also give effect to the following deductions for the years indicated, which were not claimed in the returns filed:—

	1941	1942	1943	First four months of 1944
Accelerated amortization				
United States (Government freight cutbacks and refunds)	\$50,000.00	\$ 127,531.24	\$ 259,654.81	\$522,741.10
Partial bad debt loss on Sacramento Northern Railway notes and advances		780,000.00	1,060,000.00	40,000.00
United States (Government reparations claims)			8,526,690.72	
(2) No excess profits taxes would have been payable on separate returns and no excess profits taxes were allocated on consolidated returns.		1,090,000.00	2,540,000.00	910,000.00

No (declared value) excess-profits taxes were paid during the period.

February 16, 1949

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 45

The Western Pacific Railroad Company

Federal income taxes for years 1942 and 1943 and the first four months of 1944 on the basis of assuming that The Western Pacific Railroad Company had filed separate returns and had the benefit of its own net operating loss carry-overs and excess profits credit carry-overs (computed as though it had filed separate returns in prior years) and the additional deductions from income as shown in the note below

Period	Tax
1942	\$2,743,638.25
1943	1,916,913.38
First four months of 1944	518,723.30
	<hr/>
Income tax for 1942 allocated on consolidated return	\$5,179,274.93
	4,144,828.87
	<hr/>
Difference.....	\$1,034,446.06
	<hr/>

Notes:

(1) The computations of the taxes tabulated above are based on the returns filed. However, the computations give effect to correction of certain errors (immaterial in the returns as filed) and to Revenue Agent's conclusions contained in reports dated June 12, 1947, covering examination of the years 1940 and 1941. The computations also give effect to the following deductions for the years indicated, which were not claimed in the returns filed:—

	1941	1942	1943	First four months of 1944
Accelerated amortization				
United States Government freight cutbacks and refunds	\$80,000.00	\$ 127,531.24	\$ 259,654.81	\$522,741.10
Partial bad debt loss on Sacramento Northern Railway notes and advances		1,160,000.00	1,570,000.00	50,000.00
United States Government reparations claims			8,526,690.72	
(2) No excess profits taxes would have been payable on separate returns and no excess profits taxes were allocated on consolidated returns.		1,090,000.00	2,540,000.00	910,000.00

No (declared value) excess-profits taxes were paid during the period.

February 16, 1949

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 46

The Western Pacific Railroad Corporation

Federal income taxes for the years 1922 to 1944, inclusive, on the basis of assuming that The Western Pacific Railroad Corporation had filed separate tax returns and comparison thereof with taxes allocated to that

Company on the basis of consolidated returns filed

Year	Tax on separate return (1)	Tax allocated on consolidated return (2)	Excess of tax on separate return over tax allocated on consolidated return
1922.....	Nil	Nil	Nil
1923.....	Nil	Nil	Nil
1924.....	\$ 57,030.24	Nil	\$ 57,030.24
1925.....	41,297.55	Nil	41,297.55
1926.....	21,094.40	\$10,429.61	10,664.79
1927.....	10,551.55	10,330.90	220.65
1928.....	22,023.22	Nil	22,023.22
1929.....	56,386.32	39,158.90	17,227.42
1930.....	56,692.98	Nil	56,692.98
1931.....	76,232.09	Nil	76,232.09
1932.....	100,209.54	Nil	100,209.54
1933.....	83,544.25	Nil	83,544.25
1934.....	82,334.04	Nil	82,334.04
1935.....	46,499.56	Nil	46,499.56
1936.....	Nil	Nil	Nil
1937.....	Nil	Nil	Nil
1938.....	Nil	Nil	Nil
1939.....	Nil	Nil	Nil
1940.....	Nil	Nil	Nil
1941.....	Nil	Nil	Nil
1942.....	Nil	Nil	Nil
1943.....	Nil	Nil	Nil
1944.....	Nil	Nil	Nil
	<u>\$653,895.74</u>	<u>\$59,919.41</u>	<u>\$593,976.33</u>

Notes:

- (1) 1922 was the first year as to which corporations had an election to file separate or consolidated returns.
- (2) The amounts shown in this column are the same as those shown in Schedule 1 of Price, Waterhouse & Co. report dated January 5, 1949.
- (3) No excess profits taxes would have been payable on separate returns and no excess profits taxes were allocated on consolidated returns.

No (declared value) excess-profits taxes were paid during the period.

January 14, 1949.

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 47

The Western Pacific Railroad Corporation

Federal income taxes for the years 1922 to 1944, inclusive, on the basis of assuming that The Western Pacific Railroad Company had filed separate tax returns and comparison thereof with taxes allocated to that Company on the basis of consolidated returns filed

Year	Tax on separate return (1)	Tax allocated on consolidated return (2)	Excess of tax on separate return over tax allocated on consolidated return
1922.....	\$ 100,962.08	\$ 82,663.92	\$ 18,298.16
1923.....	215,568.99	Nil	215,568.99
1924.....	151,455.91	Nil	151,455.91
1925.....	310,286.32	310,477.26	(190.94)
1926.....	365,076.26	358,720.53	6,355.73
1927.....	94,051.47	98,569.77	(4,518.30)
1928.....	78,156.58	99,322.29	(21,165.71)
1929.....	57,219.42	14,153.75	43,065.67
1930.....	Nil	Nil	Nil
1931.....	Nil	Nil	Nil
1932.....	Nil	Nil	Nil
1933.....	Nil	Nil	Nil
1934.....	Nil	Nil	Nil
1935.....	Nil	Nil	Nil
1936.....	Nil	Nil	Nil
1937.....	Nil	Nil	Nil
1938.....	Nil	Nil	Nil
1939.....	Nil	Nil	Nil
1940.....	Nil	Nil	Nil
1941.....	Nil	Nil	Nil
Totals	<u>\$1,372,777.03</u>	<u>\$963,907.52</u>	<u>\$408,869.51</u>

Notes:

- (1) 1922 was the first year as to which corporations had an election to file separate or consolidated returns.
- (2) The amounts shown in this column are the same as those shown in Schedule 1 of Price, Waterhouse & Co. report dated January 5, 1949.
- (3) No excess profits taxes would have been payable on separate returns and no excess profits taxes were allocated on consolidated returns.

No (declared value) excess-profits taxes were paid during the period.

February 15, 1949.

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 49B

(Identification Only)

Witness.....

Exhibit

In the District Court of The United States for the Northern District
of California Southern Division

The Western Pacific Railroad Corporation vs. The Western Pacific
Railroad Company et al, No. 26508-G

Record of Weekly Sales of Preferred and Common Shares of The Western Pacific Railroad Company on New York Stock Exchange Jan. 1, 1945, to Oct. 31, 1946, as published in "The Commercial and Financial Chronicle" of New York. (Weeks begin Saturday and end Friday.)

Week Ending	Preferred			Common		
	High	Low	Volume	High	Low	Volume
	(Dollars)		(Shares)	(Dollars)		(Shares)
1945						
January 5.....	73	64 $\frac{1}{4}$	9100	38	30 $\frac{1}{2}$	11200
January 12.....	73 $\frac{1}{4}$	71	3700	37 $\frac{3}{4}$	34 $\frac{3}{8}$	5500
January 19.....	70 $\frac{3}{4}$	65	3800	35	32	10300
January 26.....	68 $\frac{1}{4}$	64 $\frac{1}{2}$	3500	36 $\frac{1}{4}$	31 $\frac{1}{2}$	5400
February 2.....	68 $\frac{1}{4}$	65 $\frac{1}{2}$	2200	35 $\frac{7}{8}$	33	3900
February 9.....	69	66 $\frac{1}{4}$	1800	35 $\frac{3}{4}$	33 $\frac{1}{2}$	3800
February 16.....	70 $\frac{1}{2}$	67 $\frac{1}{8}$	1400	36 $\frac{1}{4}$	34	3200
February 23.....	71	69 $\frac{1}{4}$	1700	36 $\frac{1}{2}$	35	3000
March 2.....	76 $\frac{1}{2}$	70 $\frac{1}{2}$	3100	37 $\frac{1}{4}$	34 $\frac{1}{2}$	4800
March 9.....	77 $\frac{1}{2}$	73	2200	37 $\frac{3}{8}$	33 $\frac{3}{8}$	3100
March 16.....	76 $\frac{1}{2}$	74	600	36 $\frac{1}{2}$	34 $\frac{1}{2}$	1900
March 23.....	78	75 $\frac{1}{4}$	1900	41 $\frac{1}{4}$	36 $\frac{5}{8}$	10300
March 30.....	76 $\frac{5}{8}$	74 $\frac{1}{2}$	1700	39 $\frac{7}{8}$	36 $\frac{1}{4}$	5600
April 6.....	76	73 $\frac{1}{2}$	600	39	38	2200
April 13.....	77	75	900	39 $\frac{3}{4}$	38 $\frac{1}{4}$	3100
April 20.....	79 $\frac{7}{8}$	77	1600	41 $\frac{7}{8}$	39 $\frac{1}{4}$	8100
April 27.....	85	79 $\frac{1}{2}$	2700	45 $\frac{1}{2}$	41 $\frac{1}{4}$	10800
May 4.....	86	83	1500	45 $\frac{3}{4}$	42	3800
May 11.....	84	81	1200	44 $\frac{1}{2}$	41	3100
May 18.....	85	82	900	43 $\frac{5}{8}$	41 $\frac{5}{8}$	1500
May 25.....	82 $\frac{7}{8}$	82	200	43	41 $\frac{1}{2}$	3200
June 1.....	85 $\frac{1}{2}$	82 $\frac{7}{8}$	300	44 $\frac{3}{4}$	43	5900
June 8.....	86	84 $\frac{1}{2}$	900	46 $\frac{5}{8}$	43 $\frac{3}{8}$	5100
June 15.....	88	86 $\frac{1}{4}$	1200	46 $\frac{3}{4}$	45	6900
June 22.....	91	87	2000	51	46 $\frac{3}{4}$	8200
June 29.....	92	90	2500	53 $\frac{3}{8}$	48 $\frac{5}{8}$	13200
July 6.....	89	86 $\frac{1}{4}$	3100	52 $\frac{3}{4}$	47 $\frac{1}{2}$	10200
July 13.....	90	86 $\frac{3}{4}$	9200	57 $\frac{1}{8}$	52 $\frac{3}{4}$	13100

Week Ending		Preferred			Common		
		High (Dollars)	Low	Volume (Shares)	High (Dollars)	Low	Volume (Shares)
1945							
July	20.....	90	85	2600	53	47 $\frac{1}{2}$	2900
July	27.....	85 $\frac{3}{4}$	81	4100	49 $\frac{3}{8}$	45 $\frac{1}{4}$	5700
August	3.....	89	84 $\frac{3}{4}$	3300	49	45 $\frac{1}{2}$	1100
August	10.....	89	86 $\frac{3}{8}$	4600	49 $\frac{1}{2}$	45 $\frac{3}{8}$	3800
August	17.....	88	85	1000	46	44	1800
August	24.....	85	81	2400	44	39	6300
August	31.....	86	85	700	48	43 $\frac{1}{2}$	3200
September	7.....	86 $\frac{7}{8}$	85 $\frac{3}{4}$	900	49	47	1300
September	14.....	87 $\frac{1}{4}$	85 $\frac{7}{8}$	1500	47 $\frac{3}{4}$	46 $\frac{1}{2}$	1200
September	21.....	86 $\frac{1}{4}$	84 $\frac{3}{8}$	900	48 $\frac{3}{4}$	44 $\frac{1}{4}$	2700
September	28.....	87	85	1000	48 $\frac{3}{4}$	47 $\frac{1}{2}$	1500
October	5.....	88 $\frac{3}{4}$	87	2900	48 $\frac{1}{4}$	47	1100
October	12.....	88 $\frac{1}{2}$	87 $\frac{3}{4}$	1700	49 $\frac{1}{4}$	46	5200
October	19.....	89 $\frac{3}{4}$	87	6000	51	49	5300
October	26.....	89 $\frac{7}{8}$	88	3400	51	49	3600
November	2.....	90	89	2800	51 $\frac{1}{2}$	48	4900
November	9.....	90 $\frac{3}{8}$	89	2400	53 $\frac{1}{4}$	51 $\frac{1}{4}$	3800
November	16.....	90 $\frac{5}{8}$	89 $\frac{1}{2}$	1600	52 $\frac{1}{4}$	48 $\frac{3}{4}$	3300
November	23.....	90 $\frac{1}{2}$	89	1600	52	49	2500
November	30.....	90	87 $\frac{7}{8}$	1400	55 $\frac{7}{8}$	49	5900
December	7.....	88 $\frac{1}{2}$	86 $\frac{1}{4}$	900	55 $\frac{7}{8}$	53 $\frac{5}{8}$	2600
December	14.....	90	86 $\frac{1}{2}$	2100	53 $\frac{1}{2}$	51 $\frac{1}{2}$	1800
December	21.....	89 $\frac{1}{2}$	87	1300	52 $\frac{1}{2}$	49	1700
December	28.....	89	88	600	51	48	1600
1946							
January	4.....	91	87 $\frac{3}{4}$	1200	49 $\frac{1}{2}$	47	2300
January	11.....	91 $\frac{7}{8}$	90 $\frac{1}{2}$	1200	51 $\frac{1}{2}$	48 $\frac{5}{8}$	4300
January	18.....	92	90 $\frac{7}{8}$	1900	53 $\frac{5}{8}$	49 $\frac{3}{4}$	4400
January	25.....	91 $\frac{1}{2}$	90 $\frac{1}{4}$	1100	53 $\frac{3}{8}$	50 $\frac{1}{4}$	3300
February	1.....	94 $\frac{3}{4}$	90 $\frac{3}{4}$	3600	55 $\frac{3}{4}$	53 $\frac{1}{2}$	3600
February	8.....	96	94 $\frac{1}{2}$	2100	56	52	5400
February	15.....	96 $\frac{1}{2}$	96 $\frac{1}{4}$	1100	53 $\frac{1}{2}$	51	1800
February	22.....	96 $\frac{1}{2}$	93	1500	54 $\frac{1}{2}$	48 $\frac{3}{8}$	2900
March	1.....	95	92 $\frac{1}{8}$	900	49 $\frac{3}{4}$	48	2600
March	8.....	95	93 $\frac{3}{8}$	1100	50	46 $\frac{1}{2}$	1700
March	15.....	94	93 $\frac{1}{2}$	1000	50	48	1900
March	22.....	96 $\frac{1}{2}$	95	1000	48 $\frac{1}{2}$	47 $\frac{1}{2}$	700
March	29.....	97	93 $\frac{7}{8}$	900	54	48	3800
April	5.....	99	96 $\frac{1}{2}$	2800	55 $\frac{1}{4}$	51 $\frac{3}{4}$	2800
April	12.....	100	98 $\frac{1}{2}$	1400	53 $\frac{3}{4}$	51	2900
April	19.....	100 $\frac{1}{2}$	99 $\frac{7}{8}$	1400	53 $\frac{1}{4}$	51	900
April	26.....	101	100 $\frac{1}{8}$	700	53	51 $\frac{1}{2}$	3200
May	3.....	100 $\frac{1}{2}$	99	1200	54	52 $\frac{1}{2}$	1000
May	10.....	99 $\frac{1}{2}$	98 $\frac{1}{4}$	500	53 $\frac{1}{2}$	50 $\frac{3}{4}$	1400

		Preferred			Common		
Week Ending		High (Dollars)	Low	Volume (Shares)	High (Dollars)	Low	Volume (Shares)
1946							
May	17.....	99	98	800	517 ⁷ / ₈	503 ³ / ₄	1200
May	24.....	987 ⁷ / ₈	98	300	553 ³ / ₄	51	5700
May	31.....	981 ¹ / ₄	973 ³ / ₄	200	553 ³ / ₄	54	2500
June	7.....	983 ³ / ₄	973 ³ / ₄	1100	543 ³ / ₄	53	1700
June	14.....	991 ¹ / ₂	98	700	561 ¹ / ₂	53	4600
June	21.....	991 ¹ / ₂	99	600	561 ¹ / ₂	54	4100
June	28.....	971 ¹ / ₂	95	700	54	503 ³ / ₄	700
July	5.....	981 ¹ / ₂	961 ¹ / ₂	500	52	513 ³ / ₄	200
July	12.....	971 ¹ / ₂	951 ¹ / ₂	1000	52	50	1800
July	19.....	971 ¹ / ₂	96	1000	51	493 ³ / ₄	700
July	26.....	981 ¹ / ₂	941 ¹ / ₂	900	501 ¹ / ₄	48	700
August	2.....	98	94	1200	481 ¹ / ₄	47	1600
August	9.....	98	96	300	471 ¹ / ₂	471 ¹ / ₂	200
August	16.....	975 ⁵ / ₈	961 ¹ / ₂	500	48	473 ³ / ₄	200
August	23.....	98	971 ¹ / ₂	300	48	46	200
August	30.....	94	903 ³ / ₄	700	441 ¹ / ₄	411 ¹ / ₄	1200
September	6.....	90	87	300	42	321 ¹ / ₈	3400
September	13.....	811 ¹ / ₄	76	800	361 ¹ / ₂	33	6200
September	20.....	81	80	900	351 ¹ / ₂	293 ³ / ₄	9400
September	27.....	761 ¹ / ₂	75	400	341 ¹ / ₄	27	6800
October	4.....	76	751 ¹ / ₄	400	34	321 ¹ / ₂	2800
October	11.....	773 ³ / ₄	71	1300	33	291 ¹ / ₄	4200
October	18.....	78	761 ¹ / ₈	300	37	311 ¹ / ₂	4500
October	25.....	79	761 ¹ / ₄	600	353 ³ / ₈	34	1900
November	1.....	79	771 ¹ / ₈	500	36	301 ¹ / ₂	2900

DEFENDANTS' EXHIBIT No. 50

69278

Treasury Department

Washington 25

(Copy)

Office of Commissioner of Internal Revenue

Address Reply To

Commissioner of Internal Revenue

And Refer To IT:P:CA WTS

Dec. 9, 1947

Atchison, Topeka & Santa Fe Railway Company

Chicago, Illinois

Attention: Mr. W. E. Davis

General Auditor

Gentlemen:

Reference is made to your letter dated March 20, 1947, in which you submit a statement of facts with respect to charges for transportation of war-time commodities for the Government.

The facts submitted indicate that beginning in 1941 and continuing throughout the war years you transported military and naval forces and property for the Government for the prosecution of the war. Transportation charges were collected from the various Government departments and reported as taxable income. At the time of rendering the bills for the transportation charges, you state that it was known to you, as well as the Government departments, that the bills were excessive because such

Defendants' Exhibit No. 50—(Continued)

bills did not reflect the lower rates in accordance with the land grants and also due to the fact that many shipments of property were of a secret nature and the contents thereof were not known to you. Furthermore, many shipments contained new commodities on which rates had not been established. It was the custom for the Government departments to pay the bills for transportation charges as presented with the understanding that adjustments would be made in accordance with section 322 of the Transportation Act of 1940 when such bills were audited by the General Accounting Office.

In accordance with section 321(a) of the Transportation Act of 1940, the Government was entitled to special rates for the transportation of military and naval forces and also military and naval property. Transportation of the military and naval forces and property is eligible for net land grant rates as provided in the several Granting Acts and Equalization Agreements. Section 322 of the same Act provides that payment for transportation of mail, persons or property for or on behalf of the United States shall be made upon presentation of the bills therefor prior to audit or settlement by the General Accounting Office. The right is reserved, however, for the General Accounting Office to deduct the amount of any overpayment for such transportation from any amount subsequently due to the carrier.

According to the schedule submitted with your

Defendants' Exhibit No. 50—(Continued)

letter, it appears that the General Accounting Office began auditing the bills for the transportation charges as early as 1942, in which year demand was made for the first refunds of the excessive transportation charges. These refunds are effective for each of the years 1942 to 1946, inclusive, and additional refunds will probably be demanded for subsequent years. During these years the amounts of the refunds were taken as deductions in your Federal tax returns. The statement submitted by you shows that excessive transportation charges were received during the years 1941 to 1945, inclusive, in the amount of \$22,170,000 and that this amount was refunded during the years 1942 to 1946, inclusive.

You state that by reason of the delay in the audit of the transportation bills by the General Accounting Office the charges collected have been subjected to high excess profits tax rates whereas the repayments have extended into the post-war years when the tax rates are much lower. Due to the repayments made, the Government has paid out and you have collected only the correct transportation charges but due to the high excess profits tax rates during the war years you feel that you have suffered a penalty because of circumstances which were entirely beyond your control. It is your view that taxable income for the several years involved should be adjusted and thus neutralize the effect of the receipt and repayment of the excessive charges.

Section 43 of the Internal Revenue Code provides that:

Defendants' Exhibit No. 50—(Continued)

“The deductions and credits (other than the corporation dividends paid credit provided in section 27) provided for in this chapter shall be taken for the taxable year in which ‘paid or accrued’ or ‘paid or incurred’, dependent upon the method of accounting upon the basis of which the net income is computed, unless in order to clearly reflect the income the deductions or credits should be taken as of a different period. * * *”

The facts presented by you show conclusively that by reporting the transportation charges as income on the accrual basis and deducting the repayments in the year in which repaid, the taxable income for the years involved is not clearly reflected and thus a large net tax is incurred due to the high tax rates during the war years.

In view of the facts and circumstances presented by you, under the authority conferred in section 43 permission is granted to allocate the repayments of the excessive transportation charges to the years in which the charges were reported as taxable income. Such adjustments may not be made in a prior year or years where the statutory period of limitation for assessing deficiencies or filing claims for refund as provided in section 322 of the Code has expired or a final closing agreement has been executed.

In this connection it is understood that you agree as follows:

1. All amounts received by you as transportation charges from the Federal Government departments

Defendants' Exhibit No. 50—(Continued)

and agencies shall be included in taxable income on the accrual basis.

2. All refunds of transportation charges made by you to the Federal Government shall be allowed as deductions in the year or years in which such transportation charges were reported as income and any deductions claimed by you in the year or years such refunds were made will be disallowed.

3. For the years 1941 to 1946, inclusive, the amount of interest on refunds of income and excess profits taxes shall be allowed only to the extent of, and limited to, the amount of interest on deficiencies resulting from these adjustments.

The adjustments agreed to above will not include any items which are the subject of presently pending claims filed on behalf of the United States by the Attorney General before the Interstate Commerce Commission for refunds from the railroads, including the Atchison, Topeka & Santa Fe Railway Company, for excessive charges for the transportation of war-time freight.

Notification from you of your agreement with this letter will constitute authority for disposition of the issues for the years involved.

Please reply within fifteen days, for the attention of IT:P:CA-WTS.

Very truly yours,

/s/ GEO. J. SCHOENEMAN,
Commissioner.

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 51
(Identification only)

Redistribution of the debits to freight revenue made during the period May 1944 to July 1948, inclusive, resulting from government cutbacks and refunds on government shipments terminated on the Western Pacific, segregated to year in which traffic moved

	Year Shipment Moved	Amount
	1939	\$ 62.33
	1940	1,535.67
	1941	53,600.86
	1942	784,927.86
	1943	1,062,694.64
Jan. to Apr.	1944	35,716.03
May to Dec.	1944	48,473.42
	1945	44,401.65
	1946	4,236.04
	1947	454.11
	1948	84.23
Total		<hr/> \$2,036,186.84

DEFENDANTS' EXHIBIT No. 53

(Identification only)

The Western Pacific Railroad Company

43 Exchange Place,

New York, November 28, 1923.

Mr. C. M. Levey, President,
The Western Pacific Railroad Company,
Mills Bldg., San Francisco, California.

Dear Mr. Levey:

I am enclosing herewith two statements showing the taxable income, as reported to the Commissioner of Internal Revenue by The Western Pacific Railroad Corporation on consolidated returns for the years 1921 and 1922, and proposed allocation of the taxes to the various companies, the income of which is included in the returns.

The total tax for 1921 (\$31,813.09) was originally paid by The Western Pacific Railroad Company and of the tax for 1922 (\$114,929.64) three-quarters has been paid by The Western Pacific Railroad Corporation, which company will pay the remaining one-quarter which will be due December 15, 1923. The method of allocation, viz., prorating the entire amount among the companies showing taxable income, is, so far as we are able to determine, the practice followed by other companies making consolidated returns.

If this plan meets with your approval, The Western Pacific Railroad Company can pay to The West-

ern Pacific Railroad Corporation from New York funds:

Tax for 1922\$77,037.34

Less tax paid by W.P.R.R.Co. in
excess of proporation for 1921 9,836.61

Net amount to pay \$67,200.73

In addition, The Western Pacific R.R. Corpora-
tion should receive from :

Western Realty Co.—1922 Tax 390.76

Standard R.&D. Co.—1922 Tax 206.87

The amounts due from other subsidiary companies will be carried by The Western Pacific Railroad Corporation pending settlement with the various companies or adjustments as may be deemed advisable upon determination of proposed reorganization of Denver System and the clearing up of pending Sacramento Northern situation.

This proposed adjustment is on the basis of tax returns as originally filed, copies of which are on file in Mr. DeGraff's office, and is subject to revision as may finally be determined by adjustments in the amount of taxable income due to examination of the accounts by the Treasury Department.

Yours truly,

/s/ S. R. BALDWIN.

DEFENDANTS' EXHIBIT No. 54

Mr. F. C. Nicodemus, Jr.,
40 Wall Street,
New York, N. Y.

Dear Mr. Nicodemus:

As you know the by-laws of this Corporation provide that the annual meeting of stockholders be held in Wilmington, Delaware, on the first Tuesday in October of each year, which this year falls on October 1st.

The annual meeting last year, you will recall, was convened on the scheduled date and adjourned sine die. Upon advice of counsel and concurrence of our Board, notices of the meeting were sent to stockholders unaccompanied by proxy or proxy statement, the latter a requirement of the S. E. C.

I should like to have your opinion as to how this year's meeting should be handled, that is, will we pursue the same course as we did last year, sending out notices only, or should we proceed in the regular way? If we do the latter, it will entail considerable labor and expense and it will be necessary at next Wednesday's meeting of the Board to name a Proxy Committee, approve form of proxy and a proxy statement.

Defendants' Exhibit No. 54—(Continued)

Won't you please give me the benefit of your advice in this at your early convenience, and oblige.

Yours very truly,

/s/ M. J. CURRY.

[Marginal Notes]: \$5,000? Amt. paid to P. & Greer plus accrual of legal services to Sloss. Election of directors 10 to 2 to fill vacancies. Amt. expended for printing and mailing.

Pierce & Greer
40 Wall Street
New York

August 28, 1940.

Mr. M. J. Curry,
Secretary and Treasurer,
The Western Pacific Railroad Corporation,
37 Wall Street,
New York City.

Dear Mr. Curry:

This refers to your letter of August 23, 1940, with reference to the annual meeting of stockholders of the Corporation scheduled to be held Tuesday, October 1st, next, at Wilmington, Delaware.

It is our judgment that you should this year pursue the same course you pursued last year. That is, issue the notice in the usual form but do not name a proxy committee or request proxies. If a quorum fails to appear, you may again pursue the same course as last year, that is, after meeting on the

Defendants' Exhibit No. 54—(Continued)
scheduled date adjourn sine die for lack of quorum.

Very truly yours,

/s/ F. C. NICODEMUS, JR.

[Stamped]: Received Aug. 28, 1940 Western Pacific Railroad Corporation.

August 2, 1941.

Mr. F. C. Nicodemus, Jr.,
40 Wall Street,
New York, N. Y.

Dear Mr. Nicodemus:

As you know, the By-laws of this Corporation provide that the annual meeting of stockholders be held in Wilmington, Delaware, on the first Tuesday in October of each year, this year being October 7th.

I should like to have your opinion as to how this meeting should be handled; that is, should we pursue the same course as we have in the past two years and send out Notice of Meeting only to the stockholders, or, should we send out notice of Meeting accompanied by Proxy and Proxy Statement. The latter method of handling would, of course, entail considerable labor and expense and it will be necessary to have a Board Meeting to name a Proxy Committee, approve form of Proxy and Proxy Statement.

Defendants' Exhibit No. 54—(Continued)

Will you please let me have the benefit of your advice in this matter, and oblige.

Yours very truly,

/s/ M. J. CURRY.

Pierce & Greer
40 Wall Street
New York

August 18, 1941.

Mr. M. J. Curry
Secretary and Treasurer
The Western Pacific Railroad Corporation
37 Wall Street
New York City

Dear Mr. Curry:

Mr. Nicodemus has asked me to reply to your letter of August 2, 1941, with reference to the annual meeting of stockholders of The Western Pacific Railroad Corporation to be held in Wilmington, Delaware, on October 7, 1941.

We are both of the opinion that this annual meeting should be handled in the same way as the annual meetings of the past two years, that is, a notice of meeting, omitting form of Proxy and Proxy Statement, should be mailed to the stockholders.

If a quorum should fail to appear it would be

Defendants' Exhibit No. 54—(Continued)
in order, as in past years, to adjourn the meeting
sine die for lack of a quorum.

Yours very truly,

/s/ H. BRUA CAMPBELL.

[Initialed]: JFW.

[Stamped]: Received Aug. 19, 1941 Western Pa-
cific Railroad Corporation.

[Stamped]: M. J. C. Aug. 19, 1941.

August 3, 1942.

Messrs. Pierce & Greer
40 Wall Street
New York, N. Y.

Gentlemen:

As you know, the By-Laws of this Corporation
provide that the Annual Meeting of Stockholders
be held in Wilmington, Delaware, on the first Tues-
day in October of each year—this year the date
being October 6th. [In Pencil]: 5th 1943.

In this connection, I should like to know whether,
in your opinion, it would be proper to pursue the
same course as we have during the past three years;
that is, mail to the stockholders a notice of meeting,
omitting form of Proxy and Proxy Statement, and,
if a quorum should fail to appear, to adjourn the
meeting sine die for lack of quorum.

Yours very truly,

/s/ M. J. CURRY.

Defendants' Exhibit No. 54—(Continued)

Pierce & Greer
40 Wall Street
New York

August 8, 1942.

Mr. M. J. Curry
President
The Western Pacific Railroad Corporation
37 Wall Street
New York City

Dear Mr. Curry:

We have your letter of August 3, 1942, with reference to the annual meeting of stockholders of the Corporation to be held this year pursuant to the provisions of the By-Laws on October 6th, being the first Tuesday in October.

In our opinion it will be proper to pursue the same course as has been taken during the past three years, namely, seasonably to mail to the stockholders a notice of meeting, omitting form of Proxy and Proxy Statement, and if a quorum should fail to appear to adjourn the meeting sine die for want of a quorum.

Yours very truly,

PIERCE & GREER.

[Initialed]: JFW.

[Stamped]: Received Aug. 8, 1942 The Western Pacific Railroad Corporation.

[Stamped]: M.J.C. Aug. 8, 1942.

Defendants' Exhibit No. 54—(Continued)

5

August 5, 1943.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Gentlemen:

As you know, the By-Laws of this Corporation provide that the Annual Meeting of Stockholders be held in Wilmington, Delaware on the first Tuesday in October of each year—this year the date being October 5th.

In view of the conditions surrounding the corporation, will you please advise what action we should take in the matter.

Yours very truly,

/s/ M. J. CURRY.

Defendants' Exhibit No. 54—(Continued)

Pierce & Greer
40 Wall Street
New York

September 10, 1943.

Mr. M. J. Curry
President
The Western Pacific Railroad Corporation
37 Wall Street
New York, 5, N. Y.

Dear Mr. Curry:

Referring to your letter to our firm dated August 5, 1943, with respect to the Annual Meeting of Stockholders of The Western Pacific Railroad Corporation, Mr. Nicodemus and I believe that in compliance with the provisions of the By-Laws of the Corporation the Secretary should seasonably mail the required notice of such meeting to the stockholders of the Company and that all that need be said in such notice is that the Annual Meeting of Stockholders of the Corporation will be held pursuant to the provisions of the By-Laws on Tuesday, October 5, 1943 at 12 o'clock noon at the principal office of the Corporation, No. 100 West 10th Street, Wilmington, Delaware, for the election of Directors of the Corporation.

Yours very truly,

/s/ H. BRUA CAMPBELL.

Defendants' Exhibit No. 54—(Continued)

[Marginal Notes]: JFW. OK to handle accdly
/s/ MJC.

[Stamped]: M.J.C. Sept. 10, 1943.

[Stamped]: Received Sept. 10, 1943 The West-
ern Pacific Railroad Corporation.

August 4, 1944.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

The by-laws of this corporation provide that its annual meeting should be held the first Tuesday in October of each year (being October 3rd this year) at 12 o'clock noon, at its corporate office, the Corporation Trust Company, Wilmington, Delaware.

As you know, in the past four years, due to conditions surrounding the corporation, we merely mailed notices of the meetings to stockholders of record as of a specified date. Meetings were held each year but due to lack of quorum were adjourned sine die.

Subsequent to the annual meeting for 1943, special meetings of the stockholders were held on Decem-

Defendants' Exhibit No. 54—(Continued)
ber 28, 1943, which recessed to various dates thereafter and finally adjourned, and on April 20, 1944, when that certain agreement between the Corporation and its three secured creditors was submitted and approved by a majority vote of the stockholders present in person or represented by proxy.

The provisions of the said agreement, as you know, have since been carried out, which included the transfer of the capital stock of The Western Pacific Railroad Company to the Reorganization Committee, etc.

In view of the aforementioned facts and other pending matters, I should like to receive your opinion as to what we should do in connection with the forthcoming meeting. It occurs to me it would be appropriate, when mailing the notices, to also include a letter over the President's name, advising the stockholders of the status of the Corporation's affairs. Do you agree?

Yours very truly,

/s/ M. J. CURRY.

Note: Saw Mr. Nicodemus today and asked for a reply to this letter and he said he would turn it over to Mr. Campbell for handling.

/s/ JFW.

8/23/44.

Defendants' Exhibit No. 54—(Continued)

Pierce & Greer
40 Wall Street
New York 5, N. Y.

September 6, 1944.

Mr. M. J. Curry

President

The Western Pacific Railroad Corporation

37 Wall Street

New York 5

Dear Mr. Curry:

Mr. Nicodemus has asked me to reply to your letter of August 4, 1944, with reference to the annual meeting of stockholders of the Corporation, which under its By-Laws is scheduled to be held on Tuesday, October 3, 1944, at 12 o'clock noon, at the principal office of the Corporation, 100 West 10th Street, Wilmington, Delaware, for the election of directors.

Mr. Nicodemus believes that the Corporation should do as it did last year, that is, have the Secretary mail to the stockholders the required notice of meeting in the customary form. He does not favor sending out to the stockholders with the above notice of meeting a letter designed to inform them as to the status of the Corporation's affairs.

Yours very truly,

/s/ H. BRUA CAMPBELL.

Defendants' Exhibit No. 54—(Continued)

[Stamped]: Received Sept. 7, 1944 Western
Pacific Railroad Co.

[Stamped]: M.J.C. Sept. 7, 1944.

MJC:LB

10 Perth Avenue
New Rochelle, N. Y.
August 3, 1945

Corporation Trust Company
100 West 10th Street
Wilmington 99, Delaware

Attention: Mr. Alfred Jervis

Dear Mr. Jervis:

This acknowledges receipt of your letter dated July 31 in regard to the annual meeting of The Western Pacific Railroad Corporation to be held October 2, 1945, at its corporate office in Wilmington, Delaware.

We will give this necessary attention and communicate further with you in the near future.

Yours very truly,

/s/ M. J. CURRY.

Defendants' Exhibit No. 54—(Continued)

Pierce & Greer
40 Wall Street
New York 5, N. Y.

August 10, 1945.

Mr. M. J. Curry
President
The Western Pacific Railroad Corporation
Room 5205, 40 Wall Street
New York 5, N. Y.

Dear Mr. Curry:

Mr. Nicodemus has asked me to reply to your letter of August 3, 1945, enclosing copy of letter dated July 31, 1945, addressed to you by the Corporation Trust Company, 100 West 10th Street, Wilmington, Delaware, with reference to the Annual Meeting of Stockholders of The Western Pacific Railroad Corporation which under its By-Laws should be held on Tuesday, October 2, 1945, at the principal office of the Corporation, 100 West 10th Street, Wilmington, Delaware, for the election of Directors.

It is Mr. Nicodemus' view as well as my own that the Corporation should proceed as it did last year, that is, have the Secretary mail to the stockholders the required notice of meeting in the customary form. It will doubtless be feasible for you to arrange to have the meeting conducted by representatives of the Corporation Trust Company in which

Defendants' Exhibit No. 54—(Continued)
event I assume that you will furnish them the information requested in the second paragraph of their letter to you of July 31, 1945, and will also arrange with said Company, as Transfer Agent, to file at the place where the meeting is to be held at least ten days before the meeting the required certified alphabetical list of stockholders entitled to vote at said meeting.

Yours very truly,

/s/ H. BRUA CAMPBELL.

[Stamped]: Received Aug. 10, 1945.

[Stamped]: M.J.C. Aug. 10, 1945.

51st Floor
40 Wall Street
New York 5, N. Y.
August 5, 1946

Messrs. Pierce and Greer, Counsel
40 Wall Street
New York 5, N. Y.

Attention—Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Herewith is copy of a letter dated July 31, 1946, from The Corporation Trust Company, Wilmington, Delaware, with reference to the annual meeting of this Corporation which is to be held in that city on Tuesday, October 1, 1946.

Defendants' Exhibit No. 54—(Continued)

I shall appreciate your early advice as to the procedure to be followed in connection with the forthcoming annual meeting.

As you know, for the past several years, annual notices of the meeting of the stockholders of record as of a specified date have been sent out. Meetings were held each year but due to lack of quorum were adjourned sine die.

Yours very truly,

THE WESTERN PACIFIC
RAILROAD CORPORATION.

/s/ M. J. CURRY,
President.

[Marginal Note]: Notice of meeting to stockholders of record as of September 11, 1946.

The Corporation Trust Company
Wilmington 99,
100 West 10th Street
Wilmington 7581

October 1, 1946.

Mr. M. J. Curry, President
The Western Pacific Railroad Corporation
10 Perth Avenue
New Rochelle, New York

Dear Sir:

The annual meeting of stockholders of your company was held at this office today at 12:00 Noon. The meeting was attended by Mr. Russell M. Van-

Defendants' Exhibit No. 54—(Continued)
Kirk of Farlee & Co. who represented in person his personal holdings of 4,500 shares of preferred stock, the holdings of Farlee & Co. of 2,141 preferred shares, that of Joan M. VanKirk the holder of 1,000 preferred shares, and John H. VanKirk the holder of 1,000 preferred shares. Mr. Harold S. Baird was also present in person representing 1,100 shares. This made the total representation in person 9,741 shares and your proxy, which you sent us for 10 shares, brought the total representation in person and by proxy to 9,751 shares.

The meeting was adjourned sine die without taking any action.

We are preparing the minutes of the meeting which we will send you tomorrow.

For your information, we might state that Mr. VanKirk made a transcript of a number of the stockholders from the list which was made available at the meeting.

Yours very truly,

THE CORPORATION TRUST
COMPANY.

/s/ L. H. HERMAN,
Assistant Secretary.

LHH:RCW

[Marginal Notes]: Noted MCV 10/3/46 copy del'd to Mr. Nicodemus 10/3/46.

[Stamped]: Received Oct. 3, 1946 The Western Pacific Railroad Corporation.

Defendants' Exhibit No. 54—(Continued)

The Corporation Trust Company

October 2, 1946.

(Copy)

Re: The Western Pacific Railroad Corporation

Mr. Russell Van Kirk
c/o Farlee & Co.
37 Wall Street
New York, New York

Dear Mr. Van Kirk:

In reference to your inquiry at the annual meeting yesterday, the cost of addressing and mailing postal cards to stockholders of the above named corporation will amount to \$25.00 per thousand. It is estimated there are presently approximately 4400 stockholders so that the cost will amount to approximately \$111.00.

As explained, the approval of the corporation should be attained before we can address and mail any communication to stockholders. It will also be necessary to furnish a sufficient supply of the postal cards to be addressed and mailed.

We are forwarding a copy of this letter to Mr. Curry, President of the corporation, as a matter of information.

Very truly yours,

THE CORPORATION TRUST
COMPANY.

2070 *Western Pacific R.R. Corp., et al., vs.*

Defendants' Exhibit No. 54—(Continued)

/s/ H. E. GRANTLAND,
Assistant Secretary.

HEG:EMT

cc Mr. M. J. Curry

[Stamped]: Received Oct. 4, 1946, The Western
Pacific Railroad Corporation.

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 55

March 8, 1945.

State of Delaware
Office of the Attorney General
Dover, Delaware

Att. Hon. William H. Bennethum:

Gentlemen:

Referring to your letter dated February 4, 1945,
in regard to franchise taxes for 1942 and 1943, in
arrears:

As there has been no improvement in the finan-
cial condition of this corporation from what it was
when we addressed a letter to your State Tax De-
partment on March 27, 1943, a copy of which was
forwarded to you with our letter dated March 21,
1944, this is to respectfully request that you grant
a one-half rate for the years 1942 and 1943 and
reduce the statutory interest rate from 12% to 4%

Defendants' Exhibit No. 55—(Continued)

per annum, as was agreed to covering the years 1940 and 1941 and, at the same time, extend to July 1, 1945, the time for payment thereof.

Inasmuch as April 1st is the deadline for the payment of the 1942 tax, your early and favorable consideration of this request will be very much appreciated.

Yours very truly,

/s/ M. J. CURRY.

cc The Corporation Trust Company
100 West Tenth St.
Wilmington 99, Delaware
Att. Mr. L. H. Herman
Wilmington Asst. Secy.

bcc. Messrs. Pierce & Greer—Att. Mr. F. C. Nicodemus, Jr.

June 28, 1944.

The Corporation Trust Company
100 West Tenth Street
Wilmington 99, Delaware.

Attention Mr. L. H. Herman, Wilmington
Assistant Secretary.

Gentlemen:

Your letter of June 15, 1944:

Herewith this Corporation's check No. 33, payable to the order of State of Delaware, State Tax

Defendants' Exhibit No. 55—(Continued)

Department in the sum of \$1,363.50 (\$1,262.50 principal and \$101.00 penalty interest—July 1, 1942 to July 1, 1944) in payment of delinquent 1941 franchise tax.

It will be appreciated if you will handle this for credit and furnish us with proper receipt.

Yours very truly,

/s/ M. J. CURRY.

bcc. Mr. F. C. Nicodemus, Jr.

March 21, 1944.

State of Delaware
Office of Attorney General
Dover, Delaware.

Att. Hon. William H. Bennethum, Deputy
Attorney General.

Gentlemen:

Referring further to your letter dated February 4, 1944, and to our letter dated February 10, 1944, to the Corporation Trust Co., Wilmington, Del., with copy to you, in regard to franchise taxes in arrears:

As the financial condition of this Corporation is practically unchanged from what it was when we addressed a letter to your State Tax Department, Wilmington, Del., on March 27, 1943, (copy attached) relative to franchise taxes for the year 1940, in arrears, and your Tax Department Board

Defendants' Exhibit No. 55—(Continued)

granted a one-half rate for the years 1940 and 1941 and reduced the statutory rate to 4% per annum, and also granted an extension of time for payment of the 1940 tax to July 1, 1943, this is to respectfully request a similar extension to July 1, 1944, for payment of the 1941 tax.

A prompt response will be very much appreciated.

Yours very truly,

/s/ M. J. CURRY.

cc. Corporation Trust Company
100 West 10th Street
Wilmington, Delaware.
Messrs. Pierce & Greer.

[Marginal Note]: Mr. Campbell read this while in my office and said "Fine"—"Okay."

/s/ MJC.

3/22/44

April 12, 1943.

State of Delaware
State Tax Department
843 King Street
Wilmington, Delaware.

Att. Mr. P. M. Bourdon, Secretary.

Dear Sirs:

I am in receipt of your letter of April 9th, in reply to mine of March 27, 1943, relative to this

Defendants' Exhibit No. 55—(Continued)
Corporation's franchise taxes for the years 1940 and 1941, in which you advise that your Board has granted the one-half rate for those years and reduced the statutory interest rate from 12 per cent to 4 per cent per annum, and has also granted an extension to July 1, 1943, pending disposition of this matter in order to avoid forfeiture of our charter on April 1, 1943.

This action on the part of your Board is very much appreciated and, as stated in my letter to you of April 8th, it will be presented at the next meeting of our Board of Directors for consideration.

Yours very truly,

/s/ M. J. CURRY.

cc. The Corporation Trust Company
100 West Tenth St.
Wilmington, Delaware.
Att. Mr. L. H. Herman.

bcc. Mr. F. C. Nicodemus, Jr.

With copy of letter from the State Tax Board.

M. J. CURRY.

Defendants' Exhibit No. 55—(Continued)

Pierce & Greer
40 Wall Street
New York

January 21, 1942.

Mr. M. J. Curry
Secretary
The Western Pacific Railroad Corporation
37 Wall Street
New York City

Dear Sir:

Replying to your letter of January 2, 1942, we enclose herewith a memorandum dealing with the possible consequences to the Corporation of delinquency in the payment of Delaware franchise taxes.

We suggest that this memorandum be submitted to the Board at its next meeting as the report of counsel on the matter. Mr. Campbell expects to attend the meeting and will be glad to make an oral report on the subject covered by the memorandum should the Board so desire.

Yours very truly,

PIERCE & GREER.

[Stamped]: Received Jan. 21, 1942, The Western Pacific Railroad Corporation.

Defendants' Exhibit No. 55—(Continued)

The Western Pacific Railroad Corporation

Memorandum as to effect of non-payment of
Delaware franchise taxes

At a meeting of the Board of Directors of The Western Pacific Railroad Corporation, held on December 18, 1941, the Chairman reported that the Delaware franchise taxes for the years 1939 and 1940, due July 1, 1940 and July 1, 1941, respectively, in the amount of \$2,525 each, have not been paid and that interest is accruing thereon at the rate of 1% per month from said due dates, and further that under the Delaware Statutes payment of the 1939 tax, plus accrued interest, must be made not later than April 1, 1942, or the Corporation's charter will be voided.

Whereupon, after discussion, the Board adopted the following resolution:

“Resolved, that the question of payment of these taxes be referred to Counsel, for investigation, to determine what effect it may have on the Corporation if payment is not made and to report to the Board the result of such investigation at its next meeting.”

The statute which voids the charter of a Delaware corporation for failure to pay its franchise tax for two years is Section 71 of the Delaware Franchise Tax Law, reading as follows:

Defendants' Exhibit No. 55—(Continued)

“If any corporation, accepting the provisions of the Constitution of the State of Delaware and coming under the provisions of the General Corporation Law of this State, or any corporation which has heretofore filed or may hereafter file a certificate of incorporation under the provisions of the said law, shall for two consecutive years neglect or refuse to pay the State any franchise tax or taxes, which has or have been, or shall be assessed against it, or which it is required to pay under the provisions of this Article, the charter of such corporation shall be void, and all powers conferred by law upon such corporation are declared inoperative, unless the State Tax Board shall for good cause shown to it, give further time for the payment of such tax or taxes, in which case a certificate thereof shall be filed by the said Board in the office of the State Tax Department stating the reason therefor.”

Then follows Section 72 of the Franchise Tax Law, which directs the State Tax Department to report such delinquent corporations to the Governor and further directs the Governor forthwith to issue his proclamation declaring that the charters of these corporations are repealed. Said Section 72 reads as follows:

“On or before the First Tuesday of January in each year, the State Tax Department shall

Defendants' Exhibit No. 55—(Continued)
report to the Governor a list of all the corporations, which for two years next preceding such report, have failed, neglected or refused to pay the franchise taxes assessed against them or due by them, under the laws of this State, and the Governor shall forthwith issue his proclamation declaring that the charters of these corporations are repealed.”

Section 73 of the Franchise Tax Law provides that the proclamation of the Governor be filed in the office of the Secretary of State, that it be advertised and that a certified copy thereof be transmitted to the Recorder of each County in the State and that

“* * * each Recorder shall, upon receipt of such certified copy, forthwith mark in brief upon the margin of the record of the Certificate of Incorporation named in said proclamation, which is of record in his office, the fact that the charter of said corporation is repealed, and the date of said repeal.”

Section 74 of the Franchise Tax Law provides that any corporation, firm, company, association, person or persons

“* * * who shall exercise or attempt to exercise any power under the Certificate of Incorporation of any corporation, which shall have been proclaimed by the Governor, after

Defendants' Exhibit No. 55—(Continued)

the issuance of such proclamation, shall be deemed guilty of a misdemeanor and shall be punished by a fine not exceeding One Thousand Dollars (\$1,000) or by imprisonment not exceeding one (1) year, or both, in the discretion of the Court."

If the charter of a Delaware corporation be repealed pursuant to the above statutes for the non-payment of franchise taxes, does it follow under the Delaware law that such corporation has ceased to exist, that it is dead and cannot be revived?

It has been held that where a charter is repealed for non-payment of taxes, there is a dissolution by operation of law. (*Berle v. Crutcher*, 60 F. (2d) 440 (C.C.A. 8th)).

But in and by Section 42 of the Stock Corporation Law, the Delaware Legislature has declared that corporations after dissolution shall continue for purposes of suit. Said Section reads as follows:

"All corporations, whether they expire by their own limitations, or are otherwise dissolved, shall nevertheless be continued for the term of three years from such expiration or dissolution bodies corporate for the purpose of prosecuting and defending suits by or against them, and of enabling them gradually to settle and close their business, to dispose of and convey their property, and to divide their capital stock but not for the purpose of continuing

Defendants' Exhibit No. 55—(Continued)
the business for which said corporation shall have been established; provided, however, that with respect to any action, suit, or proceeding begun or commenced by or against the corporation prior to such expiration or dissolution and with respect to any action, suit or proceeding begun or commenced by or against the corporation within three years after the date of such expiration or dissolution, such corporation shall only for the purpose of such actions, suits or proceedings so begun or commenced be continued bodies corporate beyond said three-year period and until any judgments, orders, or decrees therein shall be fully executed."

Moreover, Section 74 of the Stock Corporation Law sets up the machinery whereby a corporation whose charter has become inoperative by law for non-payment of taxes may procure a restoration of its charter, and provides that such reinstatement shall validate all contracts, acts, matters and things made, done and performed within the scope of its charter by such corporation, its officers and agents during the time when such charter was inoperative or void or after its expiration by limitation, with the same force and effect and to all intents and purposes as if said charter had at all times remained in full force and effect.

It is clear from the foregoing that to allow the 1939 franchise tax of The Western Pacific Railroad

Defendants' Exhibit No. 55—(Continued)

Corporation to remain unpaid after April 1, 1942, will not result in the complete and final extinguishment of said corporation.

The scope and effect of the statutory provisions above referred to have been considered and defined in the following leading cases:

Watts v. Liberty Royalties Corporation, 106 F. (2d) 941

Eastman Gardiner & Co. v. Warren, 109 F. (2d) 193

In Watts v. Liberty Royalties Corporation, it was held that a Delaware corporation does not cease to exist on suspension or forfeiture of its charter for non-payment of annual license fees and that it may bring proceedings for reorganization under the Federal Bankruptcy Act (77B) even after the three years allowed by the Delaware law to wind up its affairs, in view of the Delaware statutes providing for revival or reinstatement of the charter.

The appellant contended that the corporation was prohibited from maintaining a voluntary action for reorganization by the fact that more than three years prior to the filing of its petition its charter had been forfeited for the non-payment of fees to the state of Delaware, and claimed that the failure to pay such fees automatically forfeited and cancelled its charter and its corporate franchises and that the only power the corporation possessed thereafter was to wind up its affairs within the three

Defendants' Exhibit No. 55—(Continued)

year period provided for by the laws of Delaware.

The Court, after referring to the various applicable Delaware statutes (which have been referred to in this memorandum) said:

“These sections of the Delaware code, when read together, are entirely inconsistent with the theory that a corporation whose charter has been suspended or forfeited for the failure to pay fees is dead and that it has ceased to exist. The Supreme Court in the Illinois case says that such a corporation, under the Illinois law, is ended for all time and for all purposes. That is not so under the laws of Delaware. If it were, life could not be breathed into the corpse, it could not be revived nor reinstated, nor could all things done by the corporation during its period of suspension be validated by its reinstatement.

Provisions similar to those in the Delaware law are found in the laws of many of the states and have frequently been interpreted by the courts. It has generally been held that where charter laws provide for a cancellation and forfeiture of a corporate charter and corporate powers for failure to pay fees and also provide for a reinstatement of the powers of the corporation and for restoration of its charter upon the payment of its fees, the penalty provisions providing for the forfeiture of its charter rights are largely for the purpose of

Defendants' Exhibit No. 55—(Continued)
collecting the charter fees and do not end the life of the corporation. (Citing California, Oregon, Washington and Colorado cases.)

So long as a corporation may be reinstated by the payment of delinquent fees and have validated all of its acts that were done while its powers were suspended, the corporation is not dead. Its powers are only in suspension and reinstatement of its charter restores it to all of its powers and validates all of its acts, including the acts done while its charter was suspended. The corporation had power to institute this proceeding for its reorganization under Section 77B."

Eastman, Gardiner & Co. v. Warren was an action against a Delaware corporation for personal injuries sustained by the appellee. The trial court upheld a demurrer to a special plea in abatement, alleging that the appellant, the Delaware corporation, had no legal existence because, since the institution of the action it had been dissolved under the laws of that State, and the plea further set forth that prior to such dissolution the corporation had sold all of its assets and distributed the proceeds to its debtors, paying only a portion of its indebtedness; that the corporation owned no property, either real, personal or mixed, that none was distributed to its stockholders, and that therefore the Court below was without jurisdiction to proceed further in the cause. In holding that the judgment of the

Defendants' Exhibit No. 55—(Continued)
lower Court should be affirmed, the Circuit Court of Appeals said in its opinion:

“The argument of appellant ignores the fact, of which we take judicial notice, that the statutes of Delaware extended appellant's life as a corporation for three years for the purpose of suing and being sued. See section 2074 of the Revised Code of Delaware for 1935. As an additional safeguard, section 2078 of said code expressly provides that dissolution shall be no cause for abatement of any action pending on the date of the dissolution of any corporation. *Harned v. Beacon Hill Real Estate Co.*, 9 Del. Ch. 411, 84 A. 229. Section 2075 permits the appointment of receivers, but their appointment is not mandatory. Statutes prolonging the existence of a dissolved corporation are remedial and should be given a liberal construction. *Helvering v. South Penn. Oil Co.*, 62 App. D. C. 373, 68 F. 2d 420.

It is contended that the above statutes do not apply where the corporation, before dissolution, disposed of all of its assets to its creditors. No decision of the State of Delaware is cited to show that the courts of that state have so construed its statutes, and our reading thereof does not lead us to such conclusion. We think the allegations of the plea did not prevent appellee from prosecuting his suit, and the judgment of the district court should be affirmed.”

Defendants' Exhibit No. 55—(Continued)

April 18, 1945.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

Enclosed, for your information, is copy of letter dated April 16, 1945, from the State Tax Board of Delaware, in regard to adjustment of franchise taxes in arrears.

Yours very truly,

/s/ M. J. CURRY.

cc. Messrs. Whitman, Ransom, Coulson & Goetz.

April 18, 1945.

State of Delaware
State Tax Department
843 King Street
Wilmington 99, Delaware.

Attention Mr. P. M. Bourdon, Secretary.

Dear Sirs:

This will acknowledge, with thanks, receipt of your letter dated April 16, 1945, in regard to adjustment in this Corporation's account in connec-

Defendants' Exhibit No. 55—(Continued)
tion with franchise taxes for the years 1942 and
1943.

Yours very truly,

/s/ M. J. CURRY.

cc. Secretary of State
State Tax Department
Dover, Delaware
Corporation Trust Company
100 West Tenth St.
Wilmington 99, Delaware.
Att. Mr. L. H. Herman, Wilmington Asst. Secy.
Mr. F. C. Nicodemus, Jr.

bcc. Messrs. Whitman, Ransom, Coulson & Goetz.

March 23, 1945.

Mr. James K. Polk
Whitman, Ransom, Coulson & Goetz
40 Wall Street
New York 5, N. Y.

Dear Mr. Polk:

You have copy of our letter dated February 21, 1945, addressed to Messrs. Pierce & Greer, Counsel for this Corporation, in regard to Delaware franchise taxes for the years 1942 and 1943, in arrears.

I now enclose copy of our letter dated March 8th, to office of Attorney General, State of Delaware, and copy of reply, dated March 22nd, from the Secretary of the State Tax Board, together with

Defendants' Exhibit No. 55—(Continued)

two copies of form 1105, to be filled in, signed, sworn to and returned not later than March 29th.

Will you please supply the pertinent facts required and return to me for execution and acknowledgment and forwarding, and oblige.

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. F. C. Nicodemus, Jr.

“Petition for commutation of Franchise Taxes.”

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 56

The Western Pacific Railroad Company
Mills Building, 220 Montgomery Street
San Francisco, California

File A-29-1
February 8, 1941

Mr. M. J. Curry, Vice President,
The Western Pacific Railroad Company,
37 Wall Street,
New York City, N. Y.

Dear Sir:

Are you now in a position to reply to my letter of December 18, 1940, quoted as follows:

“While the Excess Profits Tax on declared value basis provides for individual returns for corpora-

Defendant's Exhibit No. 56—(Continued)
tions, it is noted that the Excess Profits, Second Revenue Act of 1940 which is in addition to the former tax, provides under Section 730, for consolidated returns which may include all affiliated companies without restriction to railroad companies as is the case with income tax returns.

Will you please advise if it is the intention of the corporation to file a consolidated return for 1940 under this Excess Profits Tax, Second Revenue Act of 1940?"

Yours truly,

/s/ D. C. DeGRAFF.

[Stamped]: Received Feb. 13, 1941. The Western Pacific Railroad Corporation.

February 10, 1941

Air Mail.

Mr. D. C. DeGraff, General Auditor,
The Western Pacific Railroad Company,
Mills Building,
San Francisco, California.

Dear Mr. DeGraff:

Referring to your letter of December 18, 1940, regarding the intention of this corporation to file a consolidated return for 1940 under the Excess Profit Tax Second Revenue Act of 1940.

I have given this matter careful thought and de-

Defendant's Exhibit No. 56—(Continued)

liberation and feel that in accordance with the provisions of Section 730a the most equitable arrangement would be for us to dispense with the filing of a consolidated return in this particular instance.

Will you please forward copies of your completed returns as filed with the Internal Revenue Department.

Very truly yours,

s/ M. J. CURRY.

[Marginal Note]: Disregard, will file Form 1121.

[Western Union Telegram Form]

1941 Mar PM 6 42

FU2 CAK—San Francisco, Calif. 6 1026A

M J Curry, Vice President:

The Western Pacific Railroad Co 37 Wall St
NYK:

Do You Wish Me to Prepare Tentative Declared Value Excess Profits Tax Returns for Each of the Four Railroad Companies Included in Consolidated Income Tax Return or Will the Final Returns I Presume You Will Have Prepared in New York Same as Last Year File All Requirements in this Respect. Presume Also You Have Secured Extension of Time for Filing These Returns and Consolidated Income Tax Return.

D. C. DeGRAFF.

Defendant's Exhibit No. 56—(Continued)

Western Union Telegram Form
Day Letter

New York, March 7, 1941

D. C. DeGraff

Western Pacific Railroad Company

Mills Building

San Francisco, Calif.

Telegram 6th relative tax returns. Find in look-into matter, our accountant, who resigned in February, misunderstood just what is required. Holding company will file consolidated return as in previous years. Extension date for filing has been granted to June sixteenth. You may therefore disregard our letter February tenth and telegram March third prepare and forward air mail two copies tentative declared value excess profits tax returns for each of four railroad companies which we will attach to the Corporation's tentative consolidated return which will be filed on or before March fifteenth. Also please forward Forms eleven twenty-two as you have done in past.

M. J. CURRY.

Defendant's Exhibit No. 56—(Continued)

Western Union Telegram Form

New York, March 1, 1945

D. C. DeGraff

Western Pacific Railroad Company

526 Mission Street

San Francisco, Calif.

Extensions to June 15th have been received for filing following consolidated income and excess profits tax returns: For the Corporation for entire year and its subsidiaries for period January 1 to May 1, 1944; Western Pacific Company and its subsidiaries covering period May 1st to end of year; Western Realty and its subsidiary covering period May 1 to end of year. Mr. Polk suggests you follow procedure outlined herein:

By March 15th we will file here tentative consolidated returns for Corporation for entire year including its subsidiaries to May 1st and you will file in San Francisco tentative consolidated return of Company and its subsidiaries from May 1st to end of year and consolidated return of Western Realty and its subsidiary from May 1st to end of year. As you know, one-fourth estimated tax liability must be paid at that time. These tentative returns are not binding so if after further calculation it is found more advantageous to file separate returns we will do so before June 15th.

Have duplicate originals Forms 1122 and 1122E, marked "tentative," for each subsidiary of Corpora-

Defendant's Exhibit No. 56—(Continued)
tion covering period to May 1st executed by proper officers; file one copy with Collector in San Francisco sending other copy here for filing. Have these forms also executed for each subsidiary of Western Pacific Company and Western Realty for period May 1st to end of year and file in San Francisco. Attach to all these forms photostatic copy of application for extension and letter granting such extension, which are being airmailed you today. Also attach completed schedules as required in letter granting extensions.

Prepare tentative declared-value returns for Company and each subsidiary and for Western Realty and Delta for entire year and have duplicate originals executed by proper officers mailing one executed form of each here and filing other in San Francisco before March 15th attaching photostatic copies of application and letter granting extensions.

Would like receive copies of all forms mentioned above for our files. Please acknowledge receipt and understanding this wire and confirm filing by wire.

M. J. CURRY

cc. Confirming (ail mail) with photostatic copies of extension and letter granting extension
Mr. James K. Polk

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 57

Via Air Mail—

July 14, 1942.

Mr. D. C. DeGraff, General Auditor,
The Western Pacific Railroad Company,
526 Mission Street,
San Francisco, Calif.

Dear Mr. DeGraff:

We are looking into the questions you raised in your letter of July 7th, File A-29-1, in connection with 1942 income tax accruals, but before answering we would appreciate reply from you on the following:

With reference to the losses sustained account abandonment of the Deep Creek Railroad Company, it has occurred to us that this loss might be considered by the Internal Revenue Bureau as a 1939 loss in view of the fact that the Interstate Commerce Commission issued its certificate permitting this abandonment July 1, 1939; operation of the line was abandoned as to interstate and intrastate traffic in August, 1939; highest bid for scrap was accepted in August, 1939; and copy of letter we have on our files, dated November 7, 1939, to Mr. Matthew from Mrs. Tyler, which reads as follows:

"Its investment in road and equipment of \$504,029.92 which realized only \$25,698.50 will be written off to profit and loss in 1939. The company will

Defendants' Exhibit No. 57—(Continued)
then have no assets except the cash on hand and will not be engaged in any business."

* * *

"Mr. DeGraff and I have conferred on any possible undesirable result of 'forgiving' any unpaid balance of debt of our Reorganization Trustees against the Deep Creek. There could be no adverse tax effect if done in 1939 as in this year there has been a total writing off of the investment in road and equipment exceeding \$500,000 except for the approximate sum of \$25,000 received. This would greatly exceed any gift to capital that could be made by forgiving outstanding indebtedness."

"I have written thus fully concerning the status of Deep Creek Railroad Company because Mr. Elsey is desirous of winding up its affairs as soon as practical. As stated above the salvage job by the purchaser of the railroad as scrap will be completed shortly and the Auditor is winding up the small outstanding interline accounts. * * *"

As we cannot find in our records any information as to why this investment, for income tax purposes, was charged off in 1940 instead of 1939, as we feel it should have been in view of the facts recited above, please advise.

Yours very truly,

/s/ M. J. CURRY,
Treasurer.

Defendants' Exhibit No. 57—(Continued)

August 25, 1942.

Via air mail—

Mr. D. C. DeGraff, General Auditor,
The Western Pacific Railroad Company,
526 Mission Street,
San Francisco, Calif.

Dear Mr. DeGraff:

With further reference to 1942 income tax accruals:

At the time our 1940 and 1941 tax returns were prepared, question arose as to which of the two years (1939 or 1940) the Deep Creek loss could be utilized. It was decided this was immaterial for the same reasons as stated in your letter, namely, that the income deficits for 1939 and 1940 were so large it really made no difference in the return for either year and the 1941 carryover would remain the same. However, we made a memorandum of this with the idea of going into the matter more thoroughly before it became necessary to make up our 1942 returns. Now that the question has come up it will enable us before filing the 1942 returns to reach a definite decision in the matter.

As stated in my telegram of the 14th, we are still undecided on the Deep Creek loss. From the information contained in our records it appears this loss should be charged off in 1939, as it is our understanding the Revenue Bureau has ruled such losses should be written off the year the securities have been ascertained as worthless. However, due to

Defendants' Exhibit No. 57—(Continued)
the large amount involved, we would not want to take it out of 1940 unless we are certain that there is no possible reason for keeping it in that year. Therefore, we should like some more information from you to support this, such as, when did title for the scrap pass to purchaser? When was scrap entirely removed? When was payment for the scrap received? In other words, any additional reason you can supply as to why this loss should be written off in 1940, other than ICC instructions that adjusting entries be made in that year, which we understand is not sufficient evidence to satisfy the Internal Revenue Bureau.

After we have determined for income tax purposes the proper year in which this loss was sustained, there are other factors which must be considered, as you know, and which may effect the Revenue Bureau's decision as to its being allowed. I mention this for the reason you can no doubt give us additional information which will be helpful in determining the question.

First, it may be considered by the Bureau as an inter-company transaction on a consolidated return, which, in some cases has been disallowed.

Secondly, if we feel it will be allowed, the loss must be adjusted, as the Bureau has ruled that losses on advances to affiliated corporations are allowable only to the extent of the excess of the amount of the advances due over the amounts of the operating losses of the affiliate, which in prior years offset

Defendants' Exhibit No. 57—(Continued)
taxable income on consolidated returns. In other words, it should not be deducted twice.

Again, it might be considered in part as a contribution to capital.

So, as stated above, before arriving at a decision it would be appreciated if you can give us this additional information.

With reference to the questions raised in your letter of July 7th as to why items of 1941 income should affect carryover of previous years: Item 26 of the "Instructions for Form 1120" for 1941, Step III—"Conversion of Net Operating Loss Carryover into Net Operating Loss Deduction" fully answer this question. However, this will have no effect on the 1942 Carryover.

The \$100 dividends mentioned in next to last paragraph of your letter should be adjusted as stated.

While on the subject of adjustments, if and when Internal Revenue Examiner inspects the Western Realty income tax return for 1941, we suggest his attention be called to the fact that net operating loss deduction was omitted from the 1941 return and a refund is therefore due.

Further, in connection with setting up of 1942 income tax accruals, we estimate the Western Pacific Railroad Corporation's income deficit for the year 1942 will be somewhere between \$480,000 and \$485,000.

Yours very truly,

/s/ M. J. CURRY.

[Endorsed]: Filed Feb. 18, 1949.

DEFENDANTS' EXHIBIT No. 58
(Identification only)

September 17, 1945

Wood, Walker & Co.,
63 Wall Street,
New York 5, N. Y.

Attn. Miss M. Abels,
Statistical Department

Gentlemen:

Your letter of September 13th, addressed to Mr. E. C. Bates, Treasurer of this Company, has been referred to this office for reply.

I notice that your communication was sent to Mr. Bates as Treasurer of The Western Pacific Railroad Corporation and I am therefore a bit uncertain as to just what you may be trying to determine.

With respect to the stock of The Western Pacific Railroad Company, I think that perhaps the best explanation is that contained in our 1944 annual report under the heading of "Taxes" which is quoted below:

"When reference is made to the Company's income for 1944 and 1943, consideration must be given to the fact that no Federal income and excess profits tax charges were included for the first four months of 1944 nor for the year 1943.

"Prior to the period of reorganization, which began August 2, 1935, and through 1943, the Company's tax returns had been made by the

then parent, The Western Pacific Railroad Corporation, a holding corporation which owned all of the Company's preferred and common stock, except directors' qualifying shares. The holding corporation filed a consolidated return for itself and its various subsidiaries, of which The Western Pacific Railroad Company was one.

"The plan of reorganization for The Western Pacific Railroad Company was confirmed on October 11, 1943, and found the preferred and common stock (owned by the holding corporation) to be "without equity or value." As a result of this loss, the consolidated return indicated no liability for 1943 Federal income or excess profits taxes. To provide against the contingency that liability of the Railroad Company for some taxes in respect of 1943 might be subsequently asserted by the Commissioner of Internal Revenue, the Reorganization Trustees obtained authority of the Court to set aside a reserve fund of \$7,100,000 invested in Government securities.

"As a part of the proceedings for effectuating the plan of reorganization, the Company's preferred and common stocks owned by the holding corporation were transferred to the Reorganization Committee on May 1st, 1944. A consolidated tax return covering the first four months was filed by the holding corporation which reflected no liability for 1944 Federal income and excess profits taxes for that period.

“To provide against the contingency that liability of the Railroad Company for some taxes for the first four months of 1944 might be subsequently asserted by the Commissioner of Internal Revenue, your Directors on March 26th, 1945, established an additional reserve fund in the amount of \$3,000,000 to be combined with the previously established reserve fund of \$7,100,000. The additional reserve fund has also been invested in Government securities. This entire reserve will be held intact to protect the cash position of the Company in the event it should be later necessary to make any payment of taxes or interest resulting from an administrative or judicial ruling adverse to the Company's contention that it was not liable for any Federal income or excess profits taxes for the calendar year 1943 and the first four months of 1944.”

You will note in the fourth paragraph of the above quotation that the corporation's holdings of the Company's stock were transferred to the Reorganization Committee on May 1, 1944, as part of the proceedings for effectuating the plan. If you are attempting to ascertain the value of the stock of the Corporation, I would suggest that you communicate directly with Mr. M. J. Curry, Room 5205, 40 Wall Street, New York 5, N. Y., who is the President of The Western Pacific Railroad Corporation.

As a matter of information, prior to its transfer to the Company's reorganization committee, all of

the stock of the Company was held by The Western Pacific Railroad Corporation and it was not dealt in on the various security exchanges. That situation, of course, no longer obtains since the Company's reorganization effected as of December 29, 1944.

Very truly yours,

/s/ CHARLES ELSEY.

bcc—Mr. M. J. Curry.

DEFENDANTS' EXHIBIT No. 59

(Identification only)

Schedule of All Purchases and Sales of Western Pacific
Railroad Corporation Preferred Stock

Date	Broker for Vendor	Purchases		
		No. of Shares	Price Per Share	Total Cost
1944				
2/23	Troster, Currie & Summers	500	$\frac{3}{8}$	\$ 218.75
2/23	E. F. Hutton & Co.	1000	$\frac{3}{8}$	391.35
2/28	L. D. Sherman & Co.	200	$\frac{3}{8}$	100.00
2/29	Troster, Currie & Summers	200	$\frac{3}{8}$	100.00
3/1	Eisele & King, Libaire, Stout & Co.	200	$\frac{1}{2}$	102.50
3/2	Hill, Thompson & Co.	35	$\frac{3}{8}$	17.50
3/3	Moore, Leonard & Lynch	100	$\frac{1}{2}$	50.00
3/18	Hill, Thompson & Co.	500	.65	325.00
3/18	M. S. Wien & Co.	200	$\frac{5}{8}$	135.00
3/20	Newburger & Hano	600	$\frac{1}{2}$	375.00
6/26	Merrill, Lynch, P. F. & B.	100	$\frac{3}{8}$	37.50
8/21	Frank C. Moore Co.	250	$\frac{1}{2}$	140.62
9/5	L. D. Sherman & Co.	800	$\frac{1}{2}$	450.00
10/9	Williams & Imbrie	2000	$\frac{5}{8}$	1,375.00
10/9	Friedman & Co.	200	$\frac{5}{8}$	125.00
12/27	M. S. Wien & Co.	100	$\frac{1}{4}$	31.25
12/28	Franklin & Co.	3538	$\frac{1}{2}$	1,990.13
1946				
1/11	M. S. Wien & Co.	600	$\frac{1}{2}$	337.50
1/16	M. S. Wien & Co.	500	$\frac{1}{2}$	281.25
9/20	L. D. Sherman & Co.	1000	$2\frac{3}{8}$	2,510.00
9/30	G. A. Saxton & Co.	200	3	600.00
9/30	M. S. Wien & Co.	200	3	600.00
Totals.....		13023		\$10,293.35

Mr. Van Kirk made no sales of said stock

Defendants' Exhibit No. 59—(Continued)

J. S. Farlee & Co.

Confirmations of All Purchases and Sales of Preferred Stock, to April 10, 1948

Trade Date	Purchases			Sales		
	Number of Shares	Price Per Share	Total Cost (incl. comm.)	Number of Shares	Price Per Share	Total Net Proceeds
			\$			Balance of Shares Held
1944						
1/10.....	200	1/8	25.00			200
2/16.....	200	3/8	75.00			400
2/16.....	100	3/8	37.50			500
2/17.....	200	1/2	100.00			700
2/18.....	200	1/2	100.00			900
2/18.....	200	1/2	100.00			1,100
3/16.....	6	1/2	3.00			1,106
3/20.....	160	5/8	103.20			1,266
3/31.....	400	9/16	250.00			1,666
12/6.....	12	1/4	3.00			1,678
12/6.....	100	3/8	43.75			1,778
12/18.....	70	1/4	21.88			1,848
12/19.....	200	1/4	75.00			2,048
12/19.....	100	3/8	37.50			2,148
12/20.....	24	1/4	6.00			2,172
1945						
3/19.....	300	3/8	150.00			2,472
3/20.....	200	1/2	100.00			2,672
4/6.....	7	1/4	1.75			2,679
4/9.....	243	5/8	151.88			2,922

Defendants' Exhibit No. 59—(Continued)

J. S. Farlee & Co. (Cont.)

Confirmations of All Purchases and Sales of Preferred Stock, to April 10, 1948

Trade Date	Purchases			Sales		
	Number of Shares	Price Per Share	Total Cost (incl. comm.)	Number of Shares	Price Per Share	Total Net Proceeds
1945						
5/11.....	100	1 1/4	125.00			3,022
5/11.....	200	1 1/8	225.00			3,222
5/11.....	200	1 3/16	237.50			3,422
5/11.....	100	1 1/8	112.50			3,522
5/11.....	500	1 1/4	625.00			4,022
5/11.....	500	1 1/4	625.00			4,522
5/11.....	500	1 1/4	625.00			5,022
5/11.....	100	1 1/4	125.00			5,122
5/11.....	300	1 1/4	375.00			5,422
5/12.....	500	1 1/8	562.50			5,422
6/5.....	100	7/8	100.00	500	1 1/4	585.00
6/5.....	200	1	200.00			5,522
10/9.....	100	5/8	62.50			5,722
10/16.....	400	1/2	250.00			5,822
10/18.....	75	1/2	46.88			6,222
10/18.....	25	5/8	15.63			6,297
10/19.....	100	5/8	62.50			6,322
10/20.....	100	5/8	62.50			6,422
10/23.....	700	1/2	393.75			6,522
10/31.....	500	1/2	281.25			7,222

Defendants' Exhibit No. 59—(Continued)

11/1.....	425	1/2	239.06			8,147
11/16.....	100	1/2	56.25			8,247
11/21.....	500	1	500.00	700	1 1/8	8,047
11/23.....	500	7/8	437.50			8,547
1946						
1/16.....	500	1/2	\$ 281.25			9,047
2/4.....	500	5/8	312.50			9,547
6/3.....	100	3	300.00			9,647
7/29.....	200	3 1/2	700.00			9,847
7/30.....	300	3 1/4	975.00			10,147
8/2.....	200	4	800.00	200	4 1/8	10,147
8/5.....	5	3 1/2	17.50			10,152
9/16.....	20	3	60.00			10,172
9/30.....	27	3	81.00			10,199
10/10.....	500	3 1/2	1,797.50			10,199
11/7.....				500	3 3/4	1,840.00
11/12.....				100	4	393.00
11/20.....				100	4 1/8	405.50
11/29.....				200	4	393.00
12/16.....	30	3 1/4	105.00	500	4	1,970.00
1947						9,329
1/2.....	100	3 1/4	325.00			9,429
1/2.....	50	3 3/8	168.75	40	4	152.60
1/7.....	100	3 1/4	325.00			9,539
1/29.....				100	4 1/4	369.00
3/18.....	100	3 1/2	350.00			9,439
						9,539

Defendants' Exhibit No. 59—(Continued)

J. S. Farlee & Co. (Cont.)

Confirmations of All Purchases and Sales of Preferred Stock, to April 10, 1948

Trade Date	Purchases			Sales			Balance of Shares Held
	Number of Shares	Price Per Share	Total Cost (incl. comm.)	Number of Shares	Price Per Share	Total Net Proceeds	
1947							
3/18.....	200	3 7/16	687.50				9,739
3/27.....				200	3 7/8	763.00	9,539
4/23.....	100	3 1/8	312.50				9,639
5/27.....	16	2 5/8	42.00				9,655
6/2.....	300	2 3/4	825.00	300	2 7/8	862.50	9,655
6/17.....	50	3 1/4	162.50	100	3 1/4	325.00	9,605
6/19.....	75	3 1/8	234.38				9,680
7/14.....				300	3 3/8	1,012.50	9,380
7/15.....	24	3 1/8	75.00				9,404
7/18.....				100	3 1/2	350.00	9,304
7/23.....	100	3 1/4	325.00				9,404
7/24.....	20	3 1/8	62.50				9,424
8/29.....	15	3 3/8	50.63				9,439
9/9.....				100	4 1/8	406.50	9,339
10/1.....	100	3 5/8	362.50				9,439
10/3.....	200	3 1/4	700.00				9,639
1948							
1/7.....	100	3	300.00				9,739

Defendants' Exhibit No. 59—(Continued)

1/14.....	100	31/6	306.25	200	21/2	500.00	9,839
2/3.....	100	23/4	275.00	100	25/8	262.50	9,939
2/4.....	175	23/4	481.25	275	3	825.00	10,114
2/5.....	100	23/8	237.50				10,214
2/5.....	200	21/4	450.00				10,414
2/7.....							10,214
2/11.....							10,114
2/16.....							9,839
2/19.....	100	27/8	287.50				9,939
2/19.....	100	3	300.00	100	31/8	312.50	10,039
2/24.....							9,939
3/2.....	300	3	900.00				10,239
3/5.....	200	3	600.00				10,439
3/11.....	100	3	300.00				10,539
Totals.....	15,254		\$22,605.29	4,715		\$13,298.10	10,539

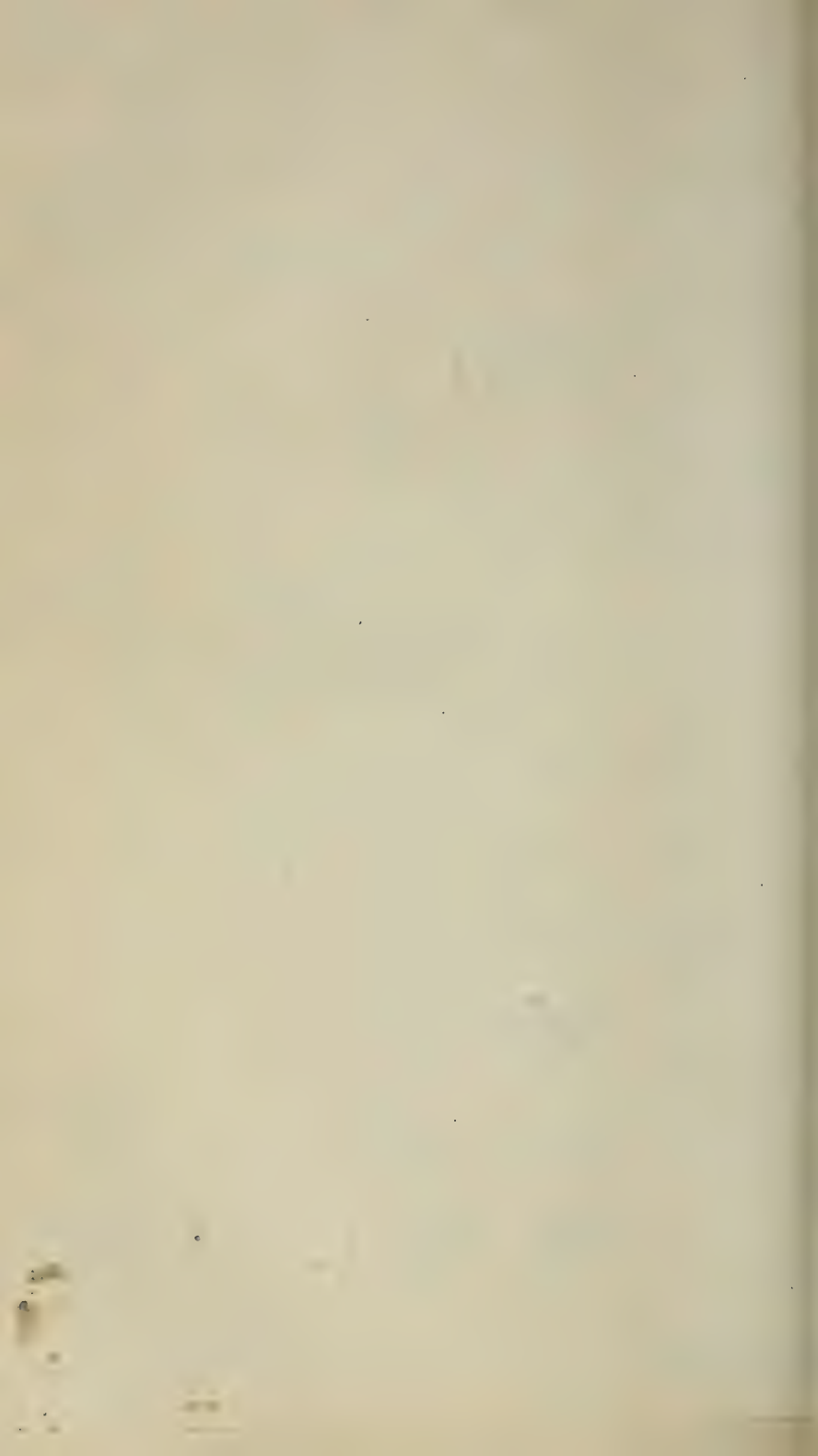
Defendants' Exhibit No. 59—(Continued)

Western Pacific Railroad Corp. Preferred Stock Given by Russell M. Van Kirk to Mrs. Russell M. Van Kirk and Owned and Held by Her

No. of Shares	Ctf. No.	Name	Date of Ctf.
100	D22125	William A. Plecity	Apr. 6, 1943
2	D028817	De Copper & Doremus	July 22, 1931
5	D028936	De Coppet & Doremus	Oct. 7, 1931
8	D04525	Norman Williams	July 15, 1925
5	D029126	De Coppet & Doremus	Dec. 3, 1931
10	D042694	De Coppet & Doremus	Apr. 13, 1943
10	D042687	De Coppet & Doremus	Apr. 8, 1943
100	D21735	Morgan Davis & Co.	Mar. 22, 1943
100	D19713	John S. Calvert	Mar. 24, 1941
100	D19711	John S. Calvert	Mar. 24, 1941
100	D19710	John S. Calvert	Mar. 24, 1941
8	D028661	Bertram E. Alanson	May 27, 1931
100	D8680	Bertram E. Alanson	May 11, 1931
100	D8679	Bertram E. Alanson	May 11, 1931
100	D8678	Bertram E. Alanson	May 11, 1931
100	D8677	Bertram E. Alanson	May 11, 1931
100	D8676	Bertram E. Alanson	May 11, 1931
100	D8675	Bertram E. Alanson	May 11, 1931
100	D8674	Bertram E. Alanson	May 11, 1931
100	D8673	Bertram E. Alanson	May 11, 1931
100	D21788	Ross B. Cameron	Mar. 24, 1943
1	D012495	Harrison Smith	Oct. 28, 1925
1	D03944	Harrison Smith	July 15, 1925
100	D15902	Silas Auerbach	Oct. 26, 1937
100	D18511	Samuel H. Popkin	Aug. 28, 1939
100	D18386	Samuel H. Popkin	June 8, 1939
100	D18387	Samuel H. Popkin	June 8, 1939
100	D18368	Samuel H. Popkin	May 23, 1939
100	D18371	Samuel H. Popkin	May 26, 1939
25	D037682	Harry Stowsky	May 12, 1936
7	D031369	Miss Priscilla F. Alden	Aug. 15, 1933
100	D18304	Peter A. Nygren	May 8, 1939
21	D042945	Rachel Booth Powers	Mar. 13, 1945
24	D042902	Halle & Stieglitz	Jan. 4, 1945
100	D21992	Gus Carras	Mar. 29, 1943
100	D21993	Gus Carras	Mar. 29, 1943
100	D21994	Gus Carras	Mar. 29, 1943
100	D21314	Louis Elkies	Feb. 10, 1943
100	D21315	Louis Elkies	Feb. 10, 1943
100	D21316	Louis Elkies	Feb. 10, 1943
100	D21317	Louis Elkies	Feb. 10, 1943
100	D21318	Louis Elkies	Feb. 10, 1943
25	D043255	O. Stuart White, Jr.	Sept. 24, 1946
24	D043492	Farlee & Co.	July 29, 1947
1	D043476	Farlee & Co.	June 26, 1947
5	D043513	Farlee & Co.	Sept. 12, 1947
41	D042792	Farlee & Co.	Mar. 22, 1944

	Year 1935	Year 1936	Year 1937	Year 1938	Year 1939	Year 1940
Director Charles Kisey	Same	Same	Same	Same	Same	Same
Director T.M.Schumacher	Same	Same	Same	Same	Same	Same
Director A. C. James	Same	Same	Same	Same	Vacant to 3/27/40 W.O.Curtis from 3/27/40	
Director J. F. Hogan	Same	Same	J. F. Hogan to 8/29/38 Vacant from 8/29/38	—	Vacant to 3/27/40 H.K.Foulter from 3/27/40	
Director E. W. Mason	Same	Same	Same	Same	Same	Same
Director D. C. DeGraff	DCD to 2/18/36 CPR from 2/18/36 to 3/30/36 DCD from 3/30/36	D.C.DeGraff	Same	Same	Same	Same
Director W. G. Bruen	Same	W. G. Bruen to 8/9/37 C. L. Drait from 8/9/37	C. L. Drait	Same	Same	Same
Director E. C. Bates	Same	Same	Same	Same	Same	Same
Director Ralph Dodd	Same	Same	Ralph Dodd to 3/10/38 Vacant from 3/10/38	—	Vacant to 3/27/40 E.W.Kingley from 3/27/40	
Director S. P. Ennis	Same	S. P. Ennis to 11/10/37 Vacant from 11/10/37	Vacant to 3/30/38 Reed Snoot from 3/30/38	Reed Snoot	Same	
Director Wm. Fries	Same	Same	Same	Same	Same	Same
Director J. E. Gorman	Same	Same	Same	Same	Same	Same
Director W. L. Hugheson	Same	Same	Same	Same	Same	Same
Director J. G. Hooper	J. G. Hooper to 8/15/35 Vacant from 8/15/35	C. W. Dooling from 2/18/36	C.W.Dooling	Same	Same	Same
Director A. W. Leashy	A. W. Leashy to 11/23/36 W. H. Kingsley from 12/1/36	W.H.Kingsley	Same	Same	Same	Same
Director J. L. Hagle	Same	Same	Same	Same	Vacant, 1/2/40 to 3/27/40 C. F. Post from 3/27/40	
Director F.J.Shapard	Same	Same	Same	Same	Same	Same
Director W. T. Smith	W. T. Smith to 8/25/36 Vacant from 8/25/36	Vacant to 3/31/37 C.F.Russell from 3/31/37	C. F. Russell	Same	C.F.Russell to 5/6/40 H.J.Curry from 5/6/40	
Director J.W.Williams	Same	Same	Same	Same	Same	Same

File of Secretary,
San Francisco, Calif.,
January 12, 1948.



LIST OF MEMBERS OF BOARD

	Year 1935	Year 1936	Year 1937	Year 1938	Year 1939
Member of Execu- tive Committee (e) T.M. Schumacher		Same	Same	Same	Same
Member of Execu- tive Committee (d) Charles Elsey		Same	Same	Same	Same
Member of Execu- tive Committee A. W. Leasty		A. W. Leasty to 12/7/36 W.M. Kingsley from 12/7/36	W. M. Kingsley	Same	Same
Member of Execu- tive Committee A. C. James		Same	Same	Same	Same
Member of Execu- tive Committee F. J. Shepard		Same	Same	Same	Same

(e) Ex-Officio. Mr. Schumacher was also Chairman of the Executive Committee.

(d) Ex-Officio. Mr. Elsey was also President of the Company.

Note: Company was reorganized effective December 29, 1944,
and Executive Committee provided for in By-Laws of
reorganized Company has not been elected.

65

Office of Secretary,
San Francisco, Calif.,
February 12, 1948.

INTERVENERS EXHIBIT No. 3

Mr. Polk:

Herewith extract from AAR weekly information letter, as per 'phone conversation of date.

M. J. CURRY

3/16/43.

Extract from Weekly Information Letter No. 504, dated March 13, 1943, from Association of American Railroads, Washington, D. C.

Internal Revenue Depreciation Account Ruling

Internal Revenue Commissioner Helvering this week refused the request of this Association that railroads desiring to change from retirement to depreciation accounting be permitted to place in the agreement an additional clause which would provide "that the reserve for accrued depreciation to the date of the change in the accounting method shall not be used in computing invested capital for excess profits tax purposes."

"Only true earned surplus or undivided profits," Mr. Helvering said, in a letter received by Mr. Fletcher, Vice President of this Association, "can be included in invested capital, and if, for any reason, the books of a railroad do not properly reflect the true surplus, such adjustments must be made as are necessary in order to arrive at the correct amount of surplus. If, for example, the depreciation actually sustained with respect to the existing property is not reflected on the books of a

corporation, earned surplus must be reduced to that extent.

“In the opinion of this office it is necessary to reduce the surplus of a corporation changing from the retirement method to the depreciation method of accounting to the extent of the amounts indicated by the reserve for depreciation required by the conditions imposed by the Commissioner before permission to change can be granted. Therefore, the Bureau cannot consent to the inclusion of the suggested clause in the agreement.”

[Endorsed]: Filed Feb. 3, 1949.

INTERVENER'S EXHIBIT No. 4

The Western Pacific Railroad Company
Western Pacific Building, 526 Mission Street
San Francisco, California

March 17, 1943.

220.4

Mr. Robert E. Coulson,
Whitman, Ransom, Coulson & Goetz,
40 Wall Street,
New York.

Dear Mr. Coulson:

This will reply to your letter of March 1st relating to depreciation on Way and Structures and its relation to Income Tax.

Intervener's Exhibit No. 4—(Continued)

Enclosed you will find a memorandum dated March 13th, with copies of attachments referred to therein, relating to negotiations between the A.A.R. and the Internal Revenue Bureau. Since Mr. DeGraff's memorandum was written, A.A.R. Accounting Circular No. 51, dated March 9th, has been received and, with its enclosures, bears on the attitude of the Internal Revenue Department concerning depreciation accounting.

It is of interest to point out that determination of loss at the time of retirement is a matter of fact, whereas the amount of depreciation accrued must always be a theoretical premise.

We will continue to use the retirement basis for establishing tax losses rather than to select one of the other alternatives offered by the Tax Commissioner. When the reorganized company takes over, the method to be followed in subsequent years can be decided upon. Any taxes now paid will probably be subject to re-examination with respect to those due from the new company, and when this whole subject is under discussion the most advantageous method can be selected.

The "brief" referred to in the attached papers, and particularly Commissioner Helvering's letter of October 24th, is one prepared by the A.A.R. dated April 20th, 1942, entitled

"A Discussion of Conditions under which
Railroads May Change from Retirement to De-

Intervener's Exhibit No. 4—(Continued)
preciation Accounting with Respect to Road
Property.

Brief for Consideration of the Bureau of Internal Revenue.”

We have but one copy here, but you can no doubt obtain one from Mr. Schumacher, or upon application to the Association.

Yours very truly,

/s/ CHARLES ELSEY.

enclosure

cc Mr. T. M. Schumacher . . . with encloures.—C. E.

Mr. Robert E. Coulson:

The attached Circular No. 51 and its enclosures were received after Mr. DeGraff wrote his memorandum on March 13th.

C. E.

San Francisco,
March 17, 1943.

Intervener's Exhibit No. 4—(Continued)

(Copy)

Association of American Railroads
Transportation Building
Washington, D. C.

Circular No. 51

March 9, 1943

File 223-2

E. H. Bunnell,
Vice President.

To Chief Accounting Officers:

Herewith is copy of three letters, dated October 24, 1942, December 9, 1942, and March 6, 1943, addressed to this Association by Mr. Guy T. Helvering, Commissioner of Internal Revenue, in the matter of conditions under which railroads may change from retirement to depreciation accounting.

These letters reflect the result of negotiations which the special tax committee conducted with the Bureau of Internal Revenue and are self-explanatory.

Out of an abundance of caution, attention is directed to the fact that a taxpayer desiring to change his method of accounting must make application to the Commissioner for permission so to do within 90 days after the beginning of the taxable year in which the change is to be made. For the year 1943, the 90-day period will expire March 31st.

Yours very truly,

/s/ E. H. BUNNELL.

Intervener's Exhibit No. 4—(Continued)

(Copy)

Treasury Department
Washington

March 6, 1943.

Office of
Commissioner of Internal Revenue

Address reply to
Commissioner of Internal Revenue and refer to
GC:I:GEL A-370657

Association of American Railroads,
Transportation Building,
Washington, D. C.

Attention: Mr. R. V. Fletcher

Sirs:

Reference is made to your letter of January 15, 1943, relating to the terms and conditions of the irrevocable agreement required by the Bureau upon granting permission to a railroad to change from retirement to depreciation accounting.

You suggest that an additional clause should be incorporated in the agreement reading "that the reserve for accrued depreciation to the date of the change in the accounting method shall not be used in computing invested capital for excess profits tax purposes."

Only true earned surplus or undivided profits can be included in invested capital, and if, for any reason, the books of a railroad do not properly reflect

Intervener's Exhibit No. 4—(Continued)

the true surplus, such adjustments must be made as are necessary in order to arrive at the correct amount of surplus. If, for example, the depreciation actually sustained with respect to the existing property is not reflected on the books of a corporation, earned surplus must be reduced to that extent.

Whether the depreciable assets of a corporation are valued on its books at the beginning of the taxable year at an amount in excess of their actual value at that time is a question of fact. *Cumberland Glass Manufacturing Co. v. Commissioner*, 44 F. (2d) 455; *Geuder, Paeschke and Frey Co. v. Commissioner*, 41 F. (2d) 308; *Haugh & Keenan Storage and Transfer Company v. Heiner*, 20 F. (2d) 921; *Northwestern States Portland Cement Company*, 7 B.T.A. 935.

In the opinion of this office it is necessary to reduce the surplus of a corporation changing from the retirement method to the depreciation method of accounting to the extent of the amounts indicated by the reserve for depreciation required by the conditions imposed by the Commissioner before permission to change can be granted. Therefore, the Bureau cannot consent to the inclusion of the suggested clause in the agreement.

Respectfully,

/s/ GUY T. HELVERING,
Commissioner.

2118 *Western Pacific R.R. Corp., et al., vs.*

Intervener's Exhibit No. 4—(Continued)

(Copy)

41998-2

Treasury Department
Washington

December 9, 1942.

Office of
Commissioner of Internal Revenue

Address Reply to
Commissioner of Internal Revenue
and refer to IT:EV:PU RCS

Association of American Railroads,
Law Department, Transportation Building,
Washington, D. C.

Attention: Mr. R. V. Fletcher
Vice-President

Sirs:

Receipt is acknowledged of your letter of November 20, 1942, inquiring with respect to the

Intervener's Exhibit No. 4—(Continued)

form of agreement required by the Bureau upon granting permission to a railroad to change from retirement to depreciation accounting.

Each railroad is required to irrevocably agree:

- (1) that a reserve for accrued depreciation in accordance with one of the options set forth in Bureau letter of October 24, 1942, shall be set up as of the date the change in accounting method is effective;
- (2) that the remaining sum to be recovered through depreciation allowances shall be limited to the cost or other basis, less the depreciation so accrued;
- (3) that neither the change of method nor the amount of depreciation so accrued shall have any effect on taxable net income for any year ending prior to the date of change in accounting method;
- (4) that the depreciation rates agreed to are subject to modification, if subsequent experience indicates that revision is necessary in order to spread the cost of the assets over their remaining useful lives; such revision, however, is not to be made retroactive; and
- (5) that complete depreciation accounting in accordance with all of the applicable sections of the Internal Revenue Code and Regulations shall be adopted for those accounts which are changed from retirement to depreciation accounting.

In connection with condition (1) above it is necessary to select the option and agree upon the specific reserve for each account to be depreciated before permission is granted.

In view of the fact that it will be impossible for

Intervener's Exhibit No. 4—(Continued)
the Bureau to make a detailed investigation of the depreciation basis the permission letter includes a mutual understanding that the basis may be corrected to conform to the allowable basis under the Internal Revenue Code should subsequent investigation disclose errors of cost or valuation. In the event of any such correction, the accrued depreciation would be appropriately adjusted, but no retroactive adjustment will be made to the depreciation which may have been allowed subsequent to the date of the change in accounting method.

Respectfully,

/s/ GUY T. HELVERING,
Commissioner.

Intervener's Exhibit No. 4—(Continued)

(Copy)

4-345-1

Treasury Department
Washington

October 24, 1942.

Office of
Commissioner of Internal Revenue
Association of American Railroads,
Transportation Building,
Washington, D. C.

In re: Conditions under which Railroads
may change from Retirement to
Depreciation Accounting with re-
spect to Road Property

Sirs:

Reference is made to conferences between your Association and the Bureau of Internal Revenue on February 18 and 19, 1942, and to your brief on the above question, dated April 20, 1942.

Your brief has been considered by the Chief Counsel of the Bureau of Internal Revenue, who has ruled in effect, that the conditions under which permission will be granted railroads to change from retirement to depreciation accounting with respect to road properties are within the discretion of the Commissioner of Internal Revenue, and that the reasonableness of these requirements are questions of fact, rather than of law.

Intervener's Exhibit No. 4—(Continued)

This office also has given careful consideration to the brief which you submitted, and has come to the conclusion that, as a condition requisite to granting permission to change from retirement to depreciation accounting, a reserve representing past accrued depreciation shall be set up at the date of the change in accounting method.

Each railroad may elect to determine its reserve by one of the following methods:

1. The accounts may be reconstructed from their beginning, or may start with the I. C. C. valuation, setting up as a reserve the difference between cost of reproduction new and cost of reproduction less accrued depreciation as determined at the valuation date. From either starting point, the capital accounts shall be carried forward, increased by additions and decreased by retirements, except that any increase in replacement costs, or additions or betterments expensed, which have been deducted for income tax purposes, may not be restored. Depreciation at rates to be agreed upon shall be computed for all years and accrued into a depreciation reserve. From this reserve shall be deducted the cost of normal retirements, but for retirements due to casualty or special obsolescence, which would have been allowable under depreciation accounting, only the accrued depreciation thereon shall be deducted.

Intervener's Exhibit No. 4—(Continued)

2. A reserve may be set up by multiplying the expired life of individual structures, or the weighted average ages of the accounts representing groups of assets, now in service, by the depreciation rates agreed upon for these assets.

3. A reserve of 30% of the total depreciable accounts at the date of change may be set up. It is to be understood that this is an overall reserve and the total amount so computed is to be allocated to the different depreciable accounts on a reasonable basis, such allocation to be a matter of agreement between each railroad and the Bureau.

Respectfully,

/s/ GUY T. HELVERING,
Commissioner.

Attendance at conferences held February 18 and 19, 1942, in the matter of substitution for income tax purposes of depreciation accounting for retirement accounting on certain classes of road property.

Treasury Department

Thos. Tarleau, Legislative Counsel (Feb. 18)

Bureau of Internal Revenue

Norman D. Cann, Asst. to Comm. (Feb. 18)

Leo Diamond, Spl. Asst. to Chief Counsel (Feb. 18-19)

- Intervener's Exhibit No. 4—(Continued)
- S. P. Hatchett, Head, Engineering and Valuation Division (Feb. 18-19)
- E. L. Lindsey, Asst. Head, Engineering and Valuation Division (Feb. 18-19)
- R. C. Staebner, Chief, Public Utilities Section (Feb. 18-19)
- C. R. Dunn, Practice and Procedure Division (Feb. 18-19)
- H. J. Donnelly, Practice and Procedure Division (Feb. 19)

Railroads

- R. C. Beckett, Gen. Atty., Illinois Central (Feb. 18)
- J. C. Kauffman, Gen. Atty., Chesapeake and Ohio (Feb. 18-19)
- R. J. Lehman, Gen. Atty., Atch., Top. & Santa Fe (Feb. 18-19)
- F. J. Fell, Jr., V.P. & Compt., Pennsylvania RR. (Feb. 18)
- T. H. Seay, Compt., Southern (Feb. 18-19)
- L. J. Tracy, Controller, Union Pacific (Feb. 18)
- R. V. Fletcher, V. Pres., A.A.R. (Feb. 18)
- E. H. Bunnell, V Pres, A.A.R. (Feb. 18-19)
- R. L. Ettenger, Jr., Asst. to V. Pres., A.A.R. (Feb 18-19)

37773-6

[Stamped]: Received Mar. 22, 1943, Western Pacific Railroad Corporation.

[Endorsed]: Filed Feb. 3, 1949.

INTERVENERS' EXHIBIT No. 5

February 21, 1945.

Messrs. Pierce & Greer
40 Wall Street
New York 5, N. Y.

Attention Mr. F. C. Nicodemus, Jr.

Dear Mr. Nicodemus:

This Corporation has received notice from the Deputy Attorney General of Delaware stating that unless it pays the 1942 franchise tax and penalty interest by April 1, 1945, the Corporation's charter will be forfeited. The notice shows the following payments due as of April 1, 1945:

1942 franchise tax.....	\$2,525.00
12% penalty interest	505.00
1943 franchise tax	2,525.00
12% penalty interest	202.00
<hr/>	
Total	\$5,757.00

I feel that upon application to the State Tax Board of Delaware, they will agree to reduce the tax and interest penalty as they did for the years 1940 and 1941. If a reduction is allowed on the same basis, there would be due on April 1st the following:

1942 franchise tax	\$1,262.50
4% penalty interest.....	88.40

1943 franchise tax	1,262.50
4% penalty interest.....	37.90

Total\$2,651.30

The question in my mind is whether we should pay these taxes or let them go by default. If we default and our charter is voided, the question arises what would be the effect on the consolidated income and excess-profits tax returns filed by the Corporation, as parent, for the years 1942, 1943 and 1944. As you know, a very large deduction was taken in 1943, which wiped out any tax liability for that year and will also have an effect upon the 1942 and 1944 consolidated returns. I understand the total tax saving to The Western Pacific Railroad Company will amount to about 15 million dollars. Therefore, I feel the payment or non-payment of these franchise taxes must be determined particularly from the Federal income tax angle.

I would suggest that before arriving at a decision in this matter you confer with the firm of Whitman, Ransom, Coulson & Goetz, our tax counsel, who are aware of this situation and are considering the consequences which the non-payment of these franchise taxes would have from an income tax viewpoint.

If it is decided these franchise taxes be paid, my personal feeling is we should pay the tax for 1943 at the same time the 1942 tax is paid, thereby avoiding further accrual of penalty interest thereon.

I would appreciate your opinion on this at your early convenience.

A copy of this letter is being sent to Mr. Polk of the firm of W.R.C. & G., for his information.

Yours very truly,

/s/ M. J. CURRY.

cc. Mr. James K. Polk

Whitman, Ransom, Coulson & Goetz.

[Endorsed]: Filed Feb. 3, 1949.

INTERVENERS' EXHIBIT No. 6

May 31, 1944.

Mr. F. C. Nicodemus, Jr.

40 Wall Street

New York 5, N. Y.

Dear Mr. Nicodemus:

As you know (see copies our letters dated March 21, 1944, to State of Delaware, Office of Attorney General, and March 31, 1944, to Corporation Trust Company, Wilmington, Delaware) the State Tax Board granted extension to July 1, 1944, for payment of the Corporation's 1941 franchise tax, which as of July 1, 1944, will amount to \$1,262.50 principal, plus penalty interest of 4% from July 1, 1942, amounting to \$101—a total of \$1,363.50.

In view of conditions surrounding the Corporation at this time, I should like to have your opinion as to what should be done in the matter of payment

2128 *Western Pacific R.R. Corp., et al., vs.*

or non-payment of the tax. If not paid on or before July 1, 1944, its charter will be voided.

Yours very truly,

/s/ M. J. CURRY.

[Endorsed]: Filed Feb. 4, 1949.

INTERVENERS' EXHIBIT No. 7

Pierce & Greer
40 Wall Street
New York 5, N. Y.

June 14, 1944.

Mr. M. J. Curry
President
The Western Pacific Railroad Corporation
37 Wall Street
New York 5, N. Y.

Dear Mr. Curry:

As I mentioned to you yesterday, I talked with Colonel Coulson about the compromise proposal respecting the Delaware franchise tax involving the total payment as of July 1, 1944, of the sum of \$1,363.50. In the course of this talk I explained to Colonel Coulson that it would be necessary to make this payment in order to continue the corporate existence of the Company through the current calendar year, and that I did not see how we could avoid making this payment out of current available cash.

I told him that I felt quite sure, and he agreed, that Mr. Buckland would recognize the necessity of this payment should he ultimately succeed in maintaining his claim of a lien on our cash derived from Standard Realty and Development Company, notwithstanding the fact that his own claim has been satisfied and he has been made whole under the Commission's Plan of Reorganization.

You may, therefore, arrange for the payment referred to in your letter to me of May 31, 1944.

Yours very truly,

/s/ F. C. NICODEMUS JR.

Check No. 33

Date Paid June 28/44

Approved for payment

/s/ M. J. CURRY,
Treasurer.

[Marginal Note]: Mem. to note & number checks in payment on June 28th.

/s/ MJC

[Endorsed]: Filed Feb. 4, 1949.

INTERVENERS' EXHIBIT No. 8

March 27, 1943.

State of Delaware
State Tax Department
843 King Street
Wilmington, Delaware

Gentlemen:

Referring to letter of February 4, 1943, from the Office of the Attorney General, in regard to this Corporation's franchise taxes for 1940 and 1941, which are unpaid. Subsequently we also received from the Corporation Trust Company of Wilmington, Delaware, statement of franchise tax due on February 4, 1943, covering both years.

We have delayed replying, pending submission of the question to our Board of Directors.

We understand that under the Delaware statutes if the tax and accrued interest for the year 1940 is not paid by April 1, 1943, the Corporation's charter will be voided. As we are desirous of preventing this, if possible, we offer the following information in the hope that you will give favorable consideration to our request for relief through a compromise payment of the amount due.

This Corporation is a holding company, owning the entire capital stock of The Western Pacific Railroad Company, a California corporation, and one half of the common capital stock of The Denver and Rio Grande Western Railroad Company, a Delaware corporation, and, in addition, other securities

of both companies, which companies have been in process of reorganization under Section 77 of the Federal Bankruptcy Act since late in 1935. Practically the entire assets of the Corporation are in these two companies, from which no income has been received since just prior to filing petitions in bankruptcy.

On March 15, 1943, the United States Supreme Court handed down its decision in the Western Pacific case, which affirmed the plan of reorganization promulgated by the Interstate Commerce Commission and approved by the Federal District Court in San Francisco, which plan declared the stock of the Railroad Company to be without value, thereby wiping out approximately 80% of this Corporation's assets. The Interstate Commerce Commission's modified plan of reorganization for the Denver and Rio Grande Western, which also declares the stock of that company to be without value, has not been certified to the Federal District Court in Denver, however, we feel that since the Supreme Court upheld the Commission in declaring the stock of the Western Pacific to be without value, the Commission will, no doubt, maintain its position that the preferred and common stock of the Denver and Rio Grande Western has no value.

Aside from the stocks of the Western Pacific Railroad, which the Court decision indicates to be without value, all of the assets of the Corporation, constituting securities of both companies, are pledged to secure loans which have been in default since 1934.

It therefore becomes necessary for the Corporation to liquidate and dissolve, which should be accomplished within a period of six months.

In view of the above facts, will you please advise if your Bureau is willing to accept a compromise payment of the 1940 franchise tax, that is, about half of the tax, and waive the interest which has accrued?

A prompt response will be very much appreciated.

Yours very truly,

/s/ M. J. CURRY.

cc. The Corporation Trust Company
100 West Tenth St.
Wilmington, Delaware
Att. Mr. L. H. Herman.

bcc. Mr. F. C. Nicodemus, Jr.

[Marginal note]: Mr. Nicodemus of course approved this——.

[Endorsed]: Filed Feb. 4, 1949.

INTERVENERS' EXHIBIT No. 9

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

December 11, 1946.

Allan P. Matthew, Esquire
Balfour Building
San Francisco, California

Dear Mr. Matthew:

This acknowledges your letter of December 7th. Evidently my night letter of December 6th was not altogether clear.

My difficulty did not arise at all from the fact that Mr. Schumacher turned over his trustee files to Mr. Curry. That he seemed to me to have a clear right to do if he so desired to the extent that he was entitled as trustee to hold the files.

What did give me some concern was the definition of what constituted trustees files. Physically, the file cabinets contained all the correspondence which Mr. Schumacher or Mr. Curry had written in their capacities as officers of the operating company. In other words, the construction given your advice was that all documents which came into existence during the period of trusteeship belonged to the trustees in their fiduciary capacity. This I hoped you did not mean by your opinion. Obviously the books of account of the company were maintained in theory during the period of trusteeship by the agent of the trustees. It would be a quite impracticable theory that these books of ac-

count must remain in possession of the fiduciary trustees.

If you meant your advice to apply to all papers affecting the operation of the railroad company during the period of trusteeship then I think the situation should be clarified by a prompt application by the railroad company to the court for an order directing the trustees to turn over to the officers of the reorganized company all papers which they held as fiduciaries and which affected the operations of the railroad company, subject, of course, to a right of inspection on the part of the trustees if any occasion therefor should arise.

If there is in the books any authority entitling Section 77 trustees operating a railroad company under supervision of the court to retain the vital records of the railroad company after their fiduciary capacity has terminated, I would certainly be interested in seeing the authority.

Naturally, my interest in the question discussed in this letter is solely in protecting the operating company in connection with the Van Kirk litigation here in New York, of which you have partial counterparts in the actions brought by the holding company in California. In this connection we have received copies of your answers in the California tax action of the holding company and I have also talked with Mr. Polk about his discussions with your office.

With all good wishes of the Season, I am
Sincerely yours,

/s/ ROBERT E. COULSON.

[Marginal Note]: Discussed with Col. Coulson and with Mr. Elsey by phone 12/16/46. Col. Coulson says nothing further to be done by us presently—or until we hear further from him. BE.

[Endorsed]: Filed Feb. 4, 1949.

INTERVENERS' EXHIBIT No. 10

February 11, 1947.

073

Via Air Mail
James K. Polk, Esq.,
c/o Carlton Hotel,
Washington, D. C.

Dear Mr. Polk:

In order that you may have definite authorization from this Company to proceed in connection with the pending controversy as to Federal income taxes for the years 1942, 1943 and 1944, as to which you hold power of attorney, I have today conferred with all available directors. All of the directors I have been able to reach, constituting a majority of the directors, have concurred in the proposal that you submit in writing to the Commissioner of Internal Revenue a definite proposal that the three years 1942, 1943 and 1944 be settled on the basis of no refund and no additional tax.

We understand that the year 1944 is involved in this controversy, so far as this Company is con-

cerned, only during the period of affiliation, that is, through April 30, 1944, and that for the balance of the year 1944 the taxes of this Company will be determined on the basis of its separate return for that period outside the affiliation.

This authorization will be formally ratified at a meeting of the Board of Directors to be held early in March, 1947.

Very truly yours,

/s/ CHARLES ELSEY.

Copy by regular mail.

[Endorsed]: Filed Feb. 4, 1949.

INTERVENERS' EXHIBIT No. 11

Wood, Walker & Co.

Members New York Stock Exchange

63 Wall Street

New York 5, N. Y.

February 24, 1948.

Mr. A. Perry Osborn
20 Exchange Place
New York 5, New York.

Dear Mr. Osborn:

On February 6, 1948, you asked us for the following information:

“A tabulation by months of Wood, Walker & Company's purchases and sales of Western

Intervenors' Exhibit No. 11—(Continued)

Pacific Railroad Company securities from Jan. 1, 1942, through 1945, and a separate monthly tabulation of such purchases and sales for the account of Mr. Wood, members of his family, any officer, director and counsel for the corporation, all during the same period."

We have examined our records, and to the best of our knowledge and belief, the following are the only transactions which would come within the above category.

A/C Anna M. Wood

- 1942 Sept. 30—Sold 1M Western Pac. R.R. Co. 5s/46 @37
Oct. 7—Sold 10M Western Pac. R.R. Co. 5s/46 @37
1943 Mar. 17—Sold 10M Western Pac. R.R. Co. 5s/46 @53³/₄
Mar. 17—Sold 10M Western Pac. R.R. Co. 5s/46 @53¹/₂
July 26—Sold 10M Western Pac. R.R. Co. 5s/46 @67¹/₂
1942 Dec. 30—Bought 10M Western Pac. R.R. Co. 5s/46 @ 36¹/₄

A/C Willis D. Wood

- 1944 Jan. 17—Sold 25M Western Pac. R.R. Co. 5s/46 @81
Feb. 3—Sold 10M Western Pac. R.R. Co. 5s/46 @89
Dec. 26—Sold 25M Western Pac. R.R. Co. 5s/46 @110¹/₄
Dec. 26—Sold 28M Western Pac. R.R. Co. 5s/46 @110¹/₄
1944 Dec. 27—Bought 53M Western Pac. R.R. Co. 5s/46 @110¹/₂
1943 Dec. 16—Sold 90shs Western Pac. R.R. Co. (Old) Comm.
\$1.00 (for the lot)

Yours very truly,

WOOD, WALKER & CO.

By /s/ D. A. MURRAY.

dm/hk

Intervenors' Exhibit No. 11—(Continued)

Wood, Walker & Co.

63 Wall Street

New York 5, N. Y.

March 10th, 1948.

Mr. Perry A. Osborn

20 Exchange Place

New York City, New York

Dear Mr. Osborn:

Am enclosing herewith for accounts of AM Wood and WD Wood the long position after purchases and sales, supplementing letter of February 24th.

Very truly yours,

/s/ MISS HELEN KOCIOLEK,
Secretary to W. D. Wood.

Supplementing Letter of Feb. 24th, 1948

Long position after purchases and sales
Western Pacific R. R. Co. Securities

Anna M. Wood Account

1942	Jan.	1—Western Pac. R.R. Co. 5s/46	Long 31M
	Sept.	30—Western Pac. R.R. Co. 5s/46	Sold 1M Long 30M
	Oct.	1—Western Pac. R.R. Co. 5s/46	Sold 10M Long 20M
	Dec.	30—Western Pac. R.R. Co. 5s/46	Bought 10M Long 30M
1943	Mar.	17—Western Pac. R.R. Co. 5s/46	Sold 10M Long 20M
	Mar.	17—Western Pac. R.R. Co. 5s/46	Sold 10M Long 10M
	July	26—Western Pac. R.R. Co. 5s/46	Sold 10M Closed

Intervenors' Exhibit No. 11—(Continued)

Willis D. Wood Account

1942 Jan. 1—Western Pac. R.R. Co. 5s/46 Long 88M

No transactions in years 1942 and 1943

1944 Jan. 17—Western Pac. R.R. Co. 5s/46 Sold 25M Long 63M

Feb. 3—Western Pac. R.R. Co. 5s/46 Sold 10M Long 53M

Dec. 26—Western Pac. R.R. Co. 5s/46 Sold 25M Long 28M

Dec. 26—Western Pac. R.R. Co. 5s/46 Sold 28M Long 28M

Dec. 26—Western Pac. R.R. Co. 5s/46 Sold 28M Closed

Dec. 27—Western Pac. R.R. Co. 5s/46

Bought 53M Long 53M

1942 Jan. 1—Western Pac. R.R. Co. (Old Comm.) Long 100 shs

No transactions in year 1942

1943 Dec. 16—Western Pac. R.R. Co. (Old Comm.)

Sold 90 shs Long 10 shs

Willis D. Wood

Western Pacific Securities

On hand end of year

Year	Shares Common (W.P.R.R. Corp.)	Shares Preferred (W.P.R.R. Corp.)
1923.....	500	200
1924.....	0	0
1925.....	0	0
1926.....	0	0
1927.....	0	500
1928.....	0	700
1929.....	1,700	2,400
1930.....	2,000	2,950
1931.....	2,000	2,950
1932.....	2,600	2,950
1933.....	100	2,000
1934.....	100	2,000
1935.....	100	2,000
1936.....	100	2,000
1937.....	100	2,000
1938.....	100	500
1939.....	100	500
1940.....	100	Closed
1941.....	100	
1942.....	100	
1943.....	10	
1944.....	10	
1945.....	10	
1946.....	10	
1947.....	10	

Interveners' Exhibit No. 11—(Continued)

Willis D. Wood (Cont.)

Western Pacific R.R. Co. 1st 5s 1946

1935.....	\$26,000
1936.....	50,000
1937.....	50,000
1938.....	68,000
1940.....	68,000
1941.....	88,000
1942.....	88,000
1943.....	88,000
1944.....	Closed

Western Pacific R.R. Co. 5s 1946

1944.....	\$53,000
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1/9/45—Exchanged for \$21,200—4½s 2014; 318 Shs. Pfd.;
247.51 Shs. Com.; Cash \$12,025.17

Year Western Pacific R.R. Co. 4½s 2014

1/ 9/45—Received in exchange	\$21,200
8/ 7/46—Purchased	800

\$22,000

5/ 3/46—Redeemed	\$ 7,000
4/12-19/47—Sold	15,000

22,000

Account Closed

Western Pacific R.R. Co. Preferred

1/ 9/45—Received in exchange	318 Shares
8/ 9/46—Purchased	32 Shares
1/ 9/48—Purchased	50 Shares

On hand 4/15/48 400 Shares

Western Pacific R.R. Co. Common

1/ 9/45—Received in exchange	247.51 Shares
8/12/46—Purchased	52.49 Shares

On hand 4/15/48 300 Shares

Intervenors' Exhibit No. 11—(Continued)

Anna M. Wood

Western Pacific Securities

On hand end of year

Year	Shares Common (W.P.R.R. Corp.)	Shares Preferred (W.P.R.R. Corp.)
1924.....	0	200
1925.....	0	0
1926.....	0	0
1927.....	0	0
1928.....	0	0
1929.....	0	200
1930.....	1,200	700
1931.....	1,200	1,100
1932.....	1,200	1,100
1933.....	1,200	1,100
1934.....	1,200	1,000
1935.....	1,200	1,000
1936.....	500	900
1937.....	500	900
1938.....	Closed	Closed

Western Pacific R.R. Co. 1st 5s 1946

1937.....	\$30,000
1939.....	31,000
1940.....	31,000
1941.....	31,000
1942.....	30,000
1943.....	Closed

[Endorsed]: Filed Feb. 9, 1949.

2142 *Western Pacific R.R. Corp., et al., vs.*

INTERVENERS' EXHIBIT No. 14

JKPBCC

February 11, 1947

Mr. Charles Elsey, President

The Western Pacific Railroad Company

526 Mission Street

San Francisco, California

Dear Mr. Elsey:

Enclosed herewith is a copy of the letter this day filed, pursuant to your authorization, with the Commissioner of Internal Revenue, Washington, D. C.

Sincerely yours,

JAMES K. POLK.

Enc.

(per BC)

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York 5, N. Y.

(Copy)

February 11, 1947

The Honorable Joseph D. Nunan, Jr.

Commissioner of Internal Revenue

Washington, D. C.

Attention: Mr. Frank Eddingfield

Re: The Western Pacific Railroad Corporation and Affiliated Corporations
1942, 1943 and 1944 Federal Income Taxes

Dear Sir:

The Western Pacific Railroad Corporation and its affiliated subsidiaries filed consolidated returns

for the calendar years 1942 and 1943 and the said Western Pacific Railroad Corporation filed a consolidated return for the calendar year 1944 including therein its said subsidiaries for the period from January 1, 1944, to April 30, 1944, during which period affiliation existed.

On the said return for 1942 a consolidated tax liability of \$4,201,821.54 was reported and duly assessed and paid. On the said return for 1943 there was reported a net loss and no taxable income. On the said return for 1944, based on a carryover of the unused 1943 net loss, there was reported no taxable income and no tax liability. A claim for refund of the tax so paid for 1942, based on a carryback of the said 1943 net loss, was filed and is now pending in your office.

The taxpayer on behalf of itself and its aforesaid affiliated subsidiaries hereby offers to settle and determine the tax liabilities of the said corporations for the said taxable years 1942, 1943 and 1944 in the amounts shown on the returns filed as aforesaid. This proposal of settlement does not relate to or affect the tax liability of the said subsidiaries from and after April 30, 1944, when their affiliated status with The Western Pacific Railroad Corporation was terminated. The within proposal is made without prejudice to any rights or claims of the parties, if the proposal is not accepted by you.

As part of this proposal The Western Pacific Railroad Corporation, on behalf of itself and its aforesaid affiliated subsidiaries agrees that, if this

proposal is accepted, it will consent to a rejection of the said claim for refund of the 1942 taxes and further agrees not to sue upon said claim or file other or further claims in respect of 1942 taxes on any ground whatsoever. It is further agreed by the said The Western Pacific Railroad Corporation on behalf of itself and its aforesaid affiliated subsidiaries that if this proposal is accepted it will execute or procure the execution of any other or further agreements or assurances requested by the Commissioner of Internal Revenue for the purpose of effectuating the settlement.

Authority for the submission of the within proposal of settlement by the undersigned is contained in a Power of Attorney heretofore filed in your office.

Respectfully,

THE WESTERN PACIFIC
RAILROAD CORPORATION,
JAMES K. POLK,
Attorney-in-Fact.

[Endorsed]: Filed Feb. 9, 1949.

INTERVENERS' EXHIBIT No. 15
(Identification Only)

June 5, 1943

E. T. Buckland, Esq.

New York, New Haven & Hartford Railroad
New Haven, Connecticut

Western Pacific

Dear Mr. Buckland:

Bob Swaine called me up the other day to urge that you and I agree promptly upon the third member of the Reorganization Committee so that that Committee can appoint counsel and get to work on documents even prior to the formal approval of the Commission Plan by security holders. I told Bob that you and I had not yet discussed the matter of the third member of the Board and that the fault is mine.

My fellow trustees in the James Foundation (which holds all the stock of A. C. James Co.) are all clearly of the opinion that it would be advisable, if practical, for our group to have representation on the Reorganization Committee. Their argument is that, owing to the substantial bond holdings of the Foundation, the Foundation will have something like 21½% of the voting stock of the reorganized company. This interest is, of course, substantially greater than that which will be held by The Railroad Credit Corporation. It is also likely to be, of necessity, a more permanent interest. I have

explained that under the Commission Plan you and your Board have an equal right with the A. C. James Co. in the designation of a **representative**. I have, however, agreed to put the problem up to you and have stated to my fellow trustees that I thought there was no conflict in interest between your organization and ours since we are both anxious to see the common stock given those marketable characteristics which will come from putting it on a dividend basis.

There is one further embarrassment in the situation which has led me to defer talking with you about the matter. My associate trustees, who feel strongly that we should have representation in the Reorganization Committee, are unanimous in feeling that no one of them should serve and that it is my duty to serve because of my close contact with the matter and my knowledge of the properties and personalities involved. This has raised a problem to which I have been giving some thought. Under the terms of Section 77 a reorganization committee serves without compensation. With this I have no quarrel. However, I have a very real interest in seeing the Federal taxes of the reorganized property placed upon a sound basis. We have quite an effective Federal tax department and my partner, James K. Polk, was retained some time ago by the trustees to take up this Federal tax matter in connection with the 1942 tax problems of the property. You no doubt realize how complicated this matter has become for a railroad which has gotten into the

excess profits areas, especially in connection with a reorganization of its capital structure. I would be extremely reluctant to have any participation, which I might have in the Reorganization Committee, disturb the relationship which Polk and our tax department have to this problem.

When Bob Swaine talked to me about this matter, I told him quite frankly about this aspect. He seemed, a little to my surprise, quite eager that the James group should have direct representation on the Committee. No doubt he feels that a preliminary commitment on their part is, under the Commission Plan, basically necessary in setting up any permanent organization because of the voting power which they can exercise under the requirement of cumulative balloting. He said he saw no objection to a dual relationship and further volunteered that if his firm were selected as counsel for the Reorganization Committee, he would feel that their responsibility to the Reorganization Committee were completely fulfilled if their tax men merely reviewed with Polk the solutions and practical determinations worked out by Polk and his associates.

I wish you would give this entire problem consideration and either write me as to your views or arrange that you and I should sit down at some convenient time when you are here in New York and discuss the entire matter.

Mr. Boyden told me early in the week on the telephone that he hoped to get out the ballots in the Western Pacific case late this week or early next

week. I still feel it is of the utmost importance to have the reorganization made effective on the last day of the present calendar year.

Sincerely yours,

ROBERT E. COULSON.

INTERVENERS' EXHIBIT No. 16

Whitman, Ransom, Coulson & Goetz
40 Wall Street, New York

June 26, 1943

Mr. M. J. Curry, President
The Western Pacific Railroad Corporation
37 Wall Street
New York, N. Y.

Dear Mr. Curry:

This acknowledges your letter of June 21st as to the present needs of The Western Pacific Railroad Corporation.

While I am sending copies of your letter and of my reply to each of the Trustees of the James Foundation, it will probably not be possible to take formal action on your proposal until after July 1st.

In any attempt to settle the affairs of the holding company in a manner which will wipe out the large deficiency claims held by the Curtiss Southwestern Company, Chase National Bank of New York and

Central Hanover Bank and Trust Company, it would probably be desirable to provide, as a part of the consideration for the cancellation of the deficiency claims, that The Western Pacific Railroad Corporation agree to cooperate, by voting its stock in the Western Pacific Railroad Company, which stock has been declared worthless by the decision of the Supreme Court, to facilitate any necessary changes in the corporate structure of the operating company to effectuate the reorganization.

In a recent telephone conversation with Mr. Arthur Grotz, of the Chase National Bank, I learned that the Chase National Bank claims a lien on the stock of the operating company owned by the holding company. This lien presumably has no validity, as it has not been approved, so far as I am informed, by the necessary vote of two-thirds of the stockholders present at a stockholders' meeting. However, this situation does create some embarrassment in working out any settlement agreement.

As to the possible cancellation of your Delaware charter by failure to pay the 1940 franchise tax on or before July 1, 1943, this probably is of more apparent than real importance. Under the Delaware law the corporation continues its existence for all necessary purposes for a period of three years.

Before the Foundation gives a final and definitive answer to your proposal, I would wish to discuss with Mr. Polk the tax aspects of the problem and make that information available to the Trustees of

2150 *Western Pacific R.R. Corp., et al., vs.*

the Foundation. You will hear from me further in this matter.

Sincerely yours,

/s/ ROBERT E. COULSON.

[Stamped]: Received June 28, 1943, The Western Pacific Railroad Corporation.

[Stamped]: M.J.C. June 28, 1943.

[Endorsed]: Filed Feb. 9, 1949.

INTERVENERS' EXHIBIT No. 17

At New York, N. Y.

June 8, 1945.

File:

Mr. H. E. Poulterer:

I have told Mr. McCready that in the event he should be served with any legal process in the future, he is to accept service and turn all papers over to Mr. H. Brua Campbell of the firm of Pierce and Greer, 40 Wall Street, New York.

I have also asked Mr. McCready to advise you, with a copy to me, of the service of any such process, together with a brief description thereof.

J. E. HENNESSY.

JEH/ss

cc: Mr. D. C. McCready

[Endorsed]: Filed Feb. 11, 1949.

INTERVENERS' EXHIBIT No. 18-A
(Identification Only)

Western Union
(Telegram Form)

San Francisco, January 28, 1944

Shelly Pierce, Financial Editor
Journal of Commerce
New York, New York

Following statement was issued here in connection our December figures Quote During the first eleven months of 1943 Western Pacific made accruals in anticipation of Federal Income and Excess Profits taxes for that year. A recent re-examination of certain provisions of the reorganization plan which calls for severe reductions in the capitalization of the company has resulted in the conclusion by the management that no Federal income and excess profits tax liability exists in respect of 1943. In view of this conclusion entries were necessarily made in December income accounts which resulted in elimination of all such tax accruals for 1943. These adjustments produced the unusual income results for the month of December and the year. Unquote.

CHARLES ELSEY.

EWE:SH

INTERVENERS' EXHIBIT 18-B
(Identification Only)

Western Union
(Telegram Form)

1944 Jan 28, PM 5 14

FU323 CAK—San Francisco, Calif, 28 154 P
T. M. Schumacher
Western Pacific RR Co. 37 Wall St., NYK—

Anticipating inquireis from newspapers and others concerning situation brought about in December figures from tax credit. Following statement was prepared and uniformly given to all inquirers without further embellishment:

“During the first eleven months of 1943 Western Pacific made accruals in anticipation of Federal income and excess profits taxes for that year. A recent re-examination of certain provisions of the Reorganization Plan which calls for severe reductions in the capitalization of the Company has resulted in the conclusion by the management that no Federal income and excess profits tax liability exists in respect of 1943. In view of this conclusion entries were necessarily made in December income accounts which resulted in elimination of all such tax accruals for 1943. These adjustments produced the unusual income results for the month of December and the year.”

Discussed this with Mr. Coulson here today and

he believes we should stand on such information without additional details. Above for your general information.

CHARLES ELSEY.

[Stamped]: Received Jan. 28, 1944, W.P.RR. Co.

[Stamped]: T. M. S. Jan. 29, 1944.

INTERVENERS' EXHIBIT 18-C

(Identification Only)

San Francisco, January 25, 1944.

073

Mr. D. C. DeGraff,

Mr. E. C. Bates,

Mr. C. L. Droit,

Mr. T. D. Brown.

Distribution of our mimeographed income statement for December and year 1943 is certain to provoke inquiries as to the unusual results springing from the elimination of Federal Income and Excess Profits Taxes for the year.

In order that we may answer such questions with uniformity, please utilize the information given below:

“During the first eleven months of 1943, Western Pacific made accruals in anticipation of Federal Income and Excess Profits taxes for that year.

“A recent re-examination of certain provisions of the Reorganization Plan, which calls

for severe reductions in the capitalization of the company, has resulted in the conclusion by the management that no Federal Income and Excess Profits tax liability exists in respect of 1943.

“In view of this conclusion, entries were necessarily made in December income accounts which resulted in elimination of all such tax accruals for 1943. These adjustments produced the unusual income results for the month of December and the year.”

If your inquirer presses for more details, I would suggest that you state that the whole matter is in the hands of our New York tax counsel.

CHARLES ELSEY.

bcc—Mr. E.W. Englebright,
Mr. P. L. Wyche,
Mr. Logan Paine.

[Marginal Notes]: This release was shown Mr. Coulson today and he thought it covered the situation sufficiently.

EW. E.,
1/28/44.

Ok'd by Mr. Elsey.
E.

INTERVENERS' EXHIBIT No. 19
(Identification Only)

McCutchen, Thomas, Matthew, Griffiths & Greene
Counselors at Law

San Francisco 4
February 8, 1944

Deliver

Mr. Charles Elsey, President,
The Western Pacific Railroad Company,
526 Mission Street,
San Francisco 5, California

The Western Pacific Railroad
Company Reorganization
Reserve Fund for Contingent Tax
Liability ~~and for Post War~~
~~Modernization and Improvement~~

Dear Mr. Elsey:

Herewith I enclose in duplicate a proposed form of petition and a proposed form of order relating to the establishment of a reserve fund to be used for the payment of any possible Federal income and excess profits tax liability for the year 1943 and for post-war modernization and improvement of the railroad. You will notice that both the petition and the order are very brief and contain no statement of the reasons why it is believed that there is no Federal tax due for 1943. I think this subject can be fully developed at the hearing, following the outline suggested in Mr. Coulson's memorandum of

Interveners' Exhibit No. 19—(Continued)
February 4, 1944, which you sent me with your letter of the same date.

~~The title for the fund suggested by Mr. Coulson was "Reserve for Contingent Tax Liabilities." This title has been expanded in the enclosed forms to "Reserve Fund for Contingent Tax Liability and for Post-War Modernization and Improvement." It seems to me to be desirable to use the term "reserve fund" instead of the word "reserve" alone. Also, I believe that there may be some advantages in including "post-war modernization and improvement" as part of the title of the fund, so that in years to come the ultimate purpose of the fund will always be clearly disclosed on the books of account and balance sheets.~~

Please let me have your comments on the enclosed forms. You may wish to consult with Mr. DeGraff in order to make certain that the proposal is not in conflict with the accounting classifications or other rules or regulations of the Interstate Commerce Commission.

I shall defer submitting these forms to Mr. Coulson until I hear from you.

Very truly yours,

/s/ ALLAN P. MATTHEW.

[Marginal Notes]: Void—Mr. Matthew will provide revision.

(To be revised.)

[Stamped]: The Western Pacific Railroad Co
President, Feb. 8, 1944.

Intervenors' Exhibit No. 19—(Continued)

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California

VOID

~~In the District Court of the United States, for the
Northern District of California, Southern Division~~

No. 26591-S

In the Matter of
THE WESTERN PACIFIC RAILROAD COM-
PANY,

Debtor.

PETITION FOR AUTHORITY TO ESTAB-
LISH A RESERVE FUND FOR CONTIN-
GENT TAX LIABILITY ~~AND FOR POST-
WAR MODERNIZATION AND IMPROVE-
MENT~~

T. M. Schumacher and Sidney M. Ehrman, the
duly appointed, qualified and acting Trustees of the
properties of the Debtor above named, hereinafter
referred to as the Trustees, hereby represent to the
Court and petition as follows:

I.

The Trustees are advised and believe that the
Debtor and the Trustees have no Federal income
~~or excess profits tax liability for the year 1943.~~

Interveners' Exhibit No. 19—(Continued)

~~However, the Commissioner of Internal Revenue~~ has not yet passed upon the question, and the Trustees believe that it is in the best interests of the estate of the Debtor to provide a reserve fund out of which 1943 Federal income and excess profits taxes may be paid in the event that liability therefor should be established. The Trustees are advised and believe that the sum of \$7,100,000 will be adequate to cover any possible liability for such taxes for the year 1943. The estate of the Debtor contains sufficient cash derived from the earnings of the railroad of the Debtor during the year 1943 to establish a reserve fund in the amount of \$7,100,000 without using funds required for other purposes.

II.

It is the judgment of the Trustees that such reserve fund should be invested in United States Treasury securities and that any portion of the fund not required in order to meet such possible tax liability should be held and used for the modernization and improvement of the railroad of the Debtor after the conclusion of the present war. The Trustees propose to designate the fund as the ~~“Reserve Fund for Contingent Tax Liability and for Post-War Modernization and Improvement.”~~

Wherefore, your petitioners pray that they be authorized to establish, out of the earnings of the railroad of the Debtor during the year 1943, a ~~reserve fund in the amount of \$7,100,000, to be desig-~~

Interveners' Exhibit No. 19—(Continued)

~~nated as the "Reserve Fund for Contingent Tax Liability and for Post War Modernization and Improvement," to be invested in United States Treasury securities, and to be used for the payment of any Federal income and excess profits taxes which may be found due for the year 1943, and, in so far as not required for that purpose, to be used for the modernization and improvement of the railroad of the Debtor after the conclusion of the present war.~~

.....,

~~Counsel for Petitioners.~~

State of California,

City and County of San Francisco—ss.

Charles Elsey, being first duly sworn, deposes and says:

That for more than twelve years last past he has been the President of The Western Pacific Railroad Company and since the appointment of the Trustees of the properties of said Company he has been their Agent in immediate charge of the railroad and other property of that Company; that he had read the foregoing petition and knows the contents thereof and the same is true of his own knowledge.

.....

Interveners' Exhibit No. 19—(Continued)

Allan P. Matthew,
1500 Balfour Building,
San Francisco 4, California

Draft

VOID

~~In the District Court of the United States, for the
Northern District of California, Southern Division~~

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD COMPANY,

Debtor.

ORDER AUTHORIZING ESTABLISHMENT
OF A RESERVE FUND FOR CONTINGENT TAX LIABILITY AND FOR POST-WAR MODERNIZATION AND IMPROVEMENT

The petition filed February, 1944, by T. M. Schumacher and Sidney M. Ehrman, the Trustees of the properties of the Debtor above named, for authority to establish a reserve fund of \$7,100,000 for contingent tax liability and for post-war modernization and improvement, came on duly to be heard and was heard this day and thereupon submitted. Good cause appearing therefor, the Court, ~~being fully advised, finds that notice of the hearing~~

Intervenors' Exhibit No. 19—(Continued)

~~upon said petition has been given as prescribed by~~
the order of this Court, that all of the averments
of said petition are true, and that it is for the best
interests of the estate of the Debtor that this order
be made.

Now, Therefore, It Is Hereby Ordered, Adjudged
and Decreed that the Trustees are hereby author-
ized to establish, with funds in their hands belong-
ing to the estate of the Debtor and derived from the
earnings of the railroad of the Debtor during the
year 1943, a reserve fund in the amount of \$7,100,-
000, to be designated as the "Reserve Fund for
Contingent Tax Liability and for Post-War Mod-
ernization and Improvement," to be invested in
United States Treasury securities, and to be used
for the payment of any Federal income and excess
profits taxes which may be found due for the year
1943, and, in so far as not required for that pur-
pose, to be used for the modernization and im-
provement of the railroad of the Debtor after the
conclusion of the present war.

Dated:, 1944.

A. F. ST. SURE,
~~Judge.~~

VOID

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD
ON APPEAL

I, C. W. Calbreath, Clerk of the District Court of the United States for the Northern District of California, do hereby certify that the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court, in the above-entitled case, and that they constitute the Record on Appeal herein as designated by the parties, to wit:

Bill of Complainant for Equitable Relief.

Answer and Counterclaim of Defendants The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company.

Answer of the Defendant The Western Realty Company.

Reply to Counterclaim of Defendants The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co., Ltd., and Standard Realty and Development Company.

Notice of Motion for Leave to Intervene as Plaintiffs.

Order Granting Leave to Intervene.

Complaint in Intervention.

Answer of the Western Pacific Railroad Corporation to Complaint in Intervention.

Answer of Defendant The Western Realty Company to Complaint in Intervention.

Affidavit of Julius Levy Applying for Temporary Restraining Order and Preliminary Injunction on Behalf of Interveners.

Order Denying Application for Temporary Restraining Order on Condition, and Pre-trial Order and Exhibit A—Stipulation and Agreement, etc.

Stipulation and Agreement between Plaintiff and Defendants Relating to Agreement with the Bureau of Internal Revenue. and Exhibit A.

Answer of the Western Pacific Railroad Company et al. to Complaint in Intervention.

Supplemental Bill of Complaint.

Answer of Defendant The Western Realty Company.

Answer of Defendants The Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway Company, Delta Finance Co. Ltd., and Standard Realty and Development Company to Plaintiff's Supplemental Bill of Complaint.

Stipulation for Substitution of Meredith H. Metzger, formerly Meredith H. Van Kirk, as a Plaintiff in Intervention.

Stipulation Correcting Trial Record and Making Certain Exhibits as Part Thereof.

Opinion.

Findings and Conclusions Proposed by Plaintiff.

Notice of Motion for Reargument and to Amend Findings of Fact and Conclusions of Law Appearing in the Court's Opinion Filed September 6, 1949.

Notice of Motion of Plaintiff and of Alexis I.

duP. Bayard, Receiver, to Join Receiver as Party Plaintiff under Rule 25(c) R.C.P. and Exhibits.

Order under Rule 25(c) Directing the Joinder of Party Plaintiff.

Defendants' Objections to Findings and Conclusions Proposed by Plaintiff.

Findings of Fact and Conclusions of Law.
Judgment.

Notice of Motion to Amend Findings and Judgment.

Order Granting Motion to Amend Judgment.
Amended Judgment.

Notice of Appeal by Plaintiffs.

Notice of Appeal by Plaintiffs in Intervention.

Designation by Appellants of Contents of Record on Appeal.

Designation by Appellees of Additional Portions of the Record, Proceedings and Evidence to be Contained in the Record on Appeal.

Docket Entries.

Plaintiff's Exhibits Nos. 1, 3a, 3b, 4a, 4b, 5a, 5b, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20a, 20b, 20c, 20d, 20e, 20f, 21, 22, 23, 24, 25, 26, 27, 28, 29, 30, 31, 32a, 32b, 33, 34a, 34b, 34c, 35, 36, 37, 38a, 38b, 39a, 39b, 39c, 39d, 39e, 39f, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60, 61, 62, 63, 64, 65, 66, 67, 68, 69, 70, 71, 72, 73, 74, 75, 76, 77a, 77b, 78a, 78b, 79a, 79b, 80, 81a, 81b, 82 and 83.

Defendants' Exhibits Nos. 1, 2, 3, 4a, 4b, 4c, 5a, 5b, 5c, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, 24a, 24b, 25, 26, 27, 28, 29, 30, 31, 32

33, 34, 35a, 35b, 36, 37a, 37b, 37c, 38a, 38b, 39, 40, 41, 42, 43, 44, 45, 46, 47, 48, 49, 50, 51, 52a, 52b, 53, 54, 55, 56, 57, 58, 59 and 60.

Intervenors' Exhibits Nos. 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18a, 18b, 18c, 19, 20 and 21.

Reporter's Transcripts:

For Monday, April 7, 1947.

Vol. 1 for Monday, August 25, 1947, 4:00 o'clock p.m.—Proceedings on Application for Temporary Restraining Order.

Vol. 2 for Tuesday, August 26, 1947, 9:00 o'clock a.m.—Proceedings on Application for Temporary Restraining Order.

For Monday, October 6, 1947—Proceedings on Hearing on Motions to Strike Portions of the Complaint in Intervention.

For Monday, November 28, 1949—Argument on Motions.

For Tuesday, January 11, 1949—Pre-Trial Conference.

Vol. 1 for Tuesday, February 1, 1949.

Vol. 2 for Wednesday, February 2, 1949.

Vol. 3 for Thursday, February 3, 1949.

Vol. 4 for Friday, February 4, 1949.

Vol. 5 for Tuesday, February 8, 1949.

Vol. 6 or Wednesday, February 9, 1949.

Vol. 7 for Thursday, February 10, 1949.

Vol. 8 for Friday, February 11, 1949.

Vol. 9 for Tuesday, February 15, 1949.

Vol. 10 for Wednesday, February 16, 1949.

2166 *Western Pacific R.R. Corp., et al., vs.*

Vol. 11 for Thursday, February 17, 1949.

Vol. 12 for Friday, February 18, 1949.

Vol. 13 for Wednesday, February 23, 1949.

In Witness Whereof, I have hereunto set my hand
and seal of said District Court, at San Francisco,
California, this 18th day of March, A. D. 1950.

C. W. CALBREATH,

Clerk.

[Seal] By /s/ M. E. VANBUREN,
Deputy Clerk.

[Endorsed]: No. 12506. United States Court of Appeals for the Ninth Circuit. Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, Appellants, vs. Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, The Western Realty Company, The Standard Realty and Development Company and Delta Finance Co., Ltd., Appellees. Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., Appellants, vs. Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, the Western Realty Company, The Standard Realty and Development Company and Delta Finance Co., Ltd., Appellees. Transcript of Record. Appeals from the United States District Court for the Northern District of California, Southern Division.

Filed March 20, 1950.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

In the United States Court of Appeals
for the Ninth Circuit

No. 12506

THE WESTERN PACIFIC RAILROAD COR-
PORATION and ALEXIS I. duP. BAYARD,
Receiver,

Plaintiffs and Appellants,

and

MEREDITH H. METZGER, HENRY OFFER-
MAN and J. S. FARLEE & CO., INC., a
Corporation,

Interveners and Appellants,

vs.

THE WESTERN PACIFIC RAILROAD COM-
PANY, et al.,

Defendants and Appellees.

STATEMENT BY APPELLANTS THE WEST-
ERN PACIFIC RAILROAD CORPORA-
TION AND ALEXIS I. duP. BAYARD,
RECEIVER, OF POINTS ON WHICH
THEY INTEND TO RELY ON APPEAL

Appellants The Western Pacific Railroad Corpo-
ration and Alexis I. duP. Bayard, Receiver, dis-
signate the following points upon which they intend
to rely on the appeal in the above-entitled cause:

1. The District Court erred in entering judg-
ment for defendants and against plaintiffs.

2. The District Court erred in failing to hold that plaintiffs are entitled to an accounting from defendant The Western Pacific Railroad Company and to a decree directing payment to plaintiffs of the entire amount of federal tax savings for the years 1942, 1943 and the first four months of 1944, amounting to \$17,201,739, resulting from the filing of consolidated federal income and excess profits tax returns in the name of the plaintiff corporation.

3. The District Court erred in failing to hold that plaintiffs are entitled to an accounting from defendant The Western Pacific Railroad Company and to a decree directing payment to the plaintiffs of some part of the above-mentioned \$17,201,739.

4. The District Court erred in holding that the defendant The Western Pacific Railroad Company was not bound to account to the plaintiffs for the benefits which said defendant obtained as the result of satisfying its federal tax liabilities by using tax credits and deductions of the plaintiff corporation at a time when the plaintiff corporation had lost its stock equity in said defendant and arising principally out of that very loss.

5. The District Court erred in failing to hold that, where the economic unity between a parent and a subsidiary corporation has been severed and the parent's stockholdings in the subsidiary have become worthless and the subsidiary utilizes or appropriates the parent's tax credit, arising from the loss of the parent's investment in the subsidiary,

by means of a consolidated return in which it satisfies its own tax liability by offsetting the parent's loss against the subsidiary's income and obtains other tax advantages from the use of the consolidated return with the parent, the former subsidiary must account to its former parent for the enrichment thus obtained.

6. The District Court erred in failing to hold that plaintiffs are entitled to an accounting from the defendants other than The Western Pacific Railroad Company and to a decree directing them to pay to the plaintiffs either all or part of their tax savings for the years 1942, 1943 and the first four months of 1944 resulting from the filing of consolidated federal income and excess profits tax returns in the name of the plaintiff corporation.

7. The District Court erred in holding that the use in consolidated returns with defendants of plaintiff corporation's loss to offset income of defendants and thus to produce tax savings was, as respects the United States, improper.

8. The District Court erred in holding that because of the alleged impropriety of the defendants' use in consolidated returns of the plaintiff corporation's loss to offset income of defendants, the plaintiffs were not entitled to an accounting of the tax savings thus resulting, and that the court should leave the parties where they are.

9. The District Court erred in failing to hold that by virtue of the stipulation filed in the District

Court on September 5, 1947, and its order of August 29, 1947, the sum of \$3,385,290 must be deemed to have been refunded to the plaintiff corporation by the Treasury Department in the ordinary course and manner prescribed by law and by that plaintiff paid into said District Court, that the said sum is now held by defendant The Western Pacific Railroad Company as agent of the District Court, that the said defendant should be directed to return said sum of \$3,385,290 to the Clerk of the District Court, and that the Clerk should be directed to deliver said sum forthwith to the plaintiffs in accordance with the District Court's opinion that the funds or tax savings resulting from the settlement with the government should be left where they are.

10. The District Court erred in holding that what plaintiff seeks is not all or a share of the tax savings but rather something in the nature of equity or value for its former ownership of stock of the defendant The Western Pacific Railroad Company, or something denied to it in the prior Reorganization Plan of The Western Pacific Railroad Company, and that recognition of said plaintiff's claim would be recognition of a right to share in the earnings of The Western Pacific Railroad Company.

11. The District Court erred in holding that Section 77 of the Bankruptcy Act or the philosophy underlying Section 77 stands as a barrier against the equitable validity of the plaintiff's claim in this cause, and that an award to the plaintiff would

in some way modify the administrative or judicial judgments in the said reorganization proceedings of the defendant The Western Pacific Railroad Company or would nullify either directly or indirectly the purpose of said Section 77.

12. The District Court erred in holding that "duality of control" is not relevant in resolving the issues in the case.

13. The District Court erred in holding that the plaintiff corporation could not have lawfully acquired any part of the tax savings here involved by voluntary agreement between the directorates of the plaintiff corporation and the defendant The Western Pacific Railroad Company.

14. The District Court erred in holding that the plaintiff corporation's right to a recovery depends on whether it could have lawfully acquired the tax savings by voluntary agreement between the directorates of the plaintiff corporation and the defendant The Western Pacific Railroad Company.

Dated: March 21, 1950.

/s/ HERMAN PHLEGER,

/s/ MAURICE E. HARRISON,

/s/ MOSES LASKY,

BROBECK, PHLEGER &
HARRISON,

/s/ FRANK C. NICODEMUS, JR.

/s/ A. PERRY OSBORN,

/s/ MAHLON DICKERSON,

/s/ NORRIS DARRELL,

/s/ LeROY R. GOODRICH,

Attorneys for Appellants The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver.

Receipt of copies admitted.

[Endorsed]: Filed Mar. 21, 1950.

[Title of Court of Appeals and Cause.]

STATEMENT BY APPELLANTS MEREDITH
H. METZGER, HENRY OFFERMAN AND
J. S. FARLEE & CO., INC., OF THE
POINTS ON WHICH THEY INTEND TO
RELY

Appellants Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., state the following points on which they intend to rely on appeal in the above-entitled case:

1. Appellants are entitled to judgment on the ground that the moneys in issue were obtained in breach of fiduciary duties to plaintiff and constitute an unjust enrichment to defendants.

2. The Court below erred in finding that the fund in issue was created in such a fashion as to

require equity to leave the parties where it found them.

3. Assuming, arguendo, that the Court below correctly determined that the parties should be left where it found them, then, pursuant to that Court's own pre-trial order, the judgment should find and leave appellants with \$3,385,290.00

4. The reorganization proceeding involving the defendant The Western Pacific Railroad Company not only fails to preclude appellants from obtaining a favorable judgment herein, but indeed permits the assertion of the instant claims against that defendant under an assumption order and agreement duly made in said proceedings.

5. Defendants' technical defenses are without merit.

Dated: March 20, 1950.

/s/ WEBSTER V. CLARK,
ROGERS and CLARK,

/s/ DAVID FREIDENRICH,

/s/ JULIUS LEVY,

Attorneys for Plaintiffs in Intervention and Appellants Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., a corporation.

Receipt of copies admitted.

[Endorsed]: Filed Mar. 21, 1950.

[Title of Court of Appeals and Cause.]

ORDER DISPENSING WITH THE PRINTING
IN THE RECORD OF CERTAIN EXHIBITS

Upon the verified application of appellants The Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, and good cause appearing therefor,

It Is Hereby Ordered that no part of plaintiffs' Exhibits 1, 2, 3A, 3B, 4A, 4B, 5A, 5B, 20A, 20B, 20C, 20D, 20E, 20F, 77A, 77B, 78A, 78B, 79A, 79B, 81A, 81B, 82 and 83 need be printed in the record herein, and that this Court will consider said exhibits in their original form without reproduction in the record.

Dated: March 24, 1950.

/s/ WILLIAM HEALY,
Circuit Judge.

/s/ HOMER BONE,

/s/ WALTER L. POPE,
Judges U. S. Court of Appeals
for the Ninth Circuit.

[Endorsed]: Filed March 27, 1950.

[Title of Court of Appeals and Cause.]

ORDER DISPENSING WITH THE PRINTING
IN THE RECORD OF CERTAIN EXHIBITS

Upon reading the verified application of appellees herein for an order dispensing with the printing of certain exhibits, and good cause appearing therefor,

It Is Hereby Ordered that no part of Plaintiffs' Exhibits 3A, 3B, 4A, 4B, 5A, 5B, 16 20A-F, 77A, 77B, 78A, 78B, 79A, 79B, 81A, 81B, 82 and 83, and no part of Defendants' Exhibits 27, 40, 42, 48, 52A, 52B and 60 need be included in the printed record herein, and this Court will consider said exhibits in their original form without reproduction in the printed record.

The Court will consider such other exhibits, which have not been designated for printing by any of the parties hereto, without reproduction in the printed record if at any time any such party shall designate such exhibits as material to the consideration of the appeal, provided that the party so designating such exhibits at its own expense shall provide the Court with printed copies thereof.

/s/ WILLIAM DENMAN,

/s/ CLIFTON MATHEWS,

/s/ WM. E. ORR,

Judges of the above-entitled
court.

[Endorsed]: Filed April 11, 1950.

No. 12506

United States
Court of Appeals
for the Ninth Circuit.

WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. duP. BAYARD, Receiver,
Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER
SOUTHERN RAILWAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY COMPANY,
THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,
Appellees.

MEREDITH H. METZGER, HENRY OFFERMAN and J. S.
FARLEE & CO., INC.,
Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER
SOUTHERN RAILWAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY COMPANY,
THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,
Appellees.

SUPPLEMENTAL
Transcript of Record

Appeals from the United States District Court,
Northern District of California,
Southern Division.

FILED

JUL 24 1950

No. 12506

**United States
Court of Appeals
for the Ninth Circuit.**

**WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. duP. BAYARD, Receiver,**
Appellants,

vs.

**WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER
SOUTHERN RAILWAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY COMPANY,
THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,**
Appellees.

**MEREDITH H. METZGER, HENRY OFFERMAN and J. S.
FARLEE & CO., INC.,**
Appellants,

vs.

**WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER
SOUTHERN RAILWAY, DEEP CREEK RAILROAD
COMPANY, THE WESTERN REALTY COMPANY,
THE STANDARD REALTY AND DEVELOPMENT
COMPANY and DELTA FINANCE CO., LTD.,**
Appellees.

**SUPPLEMENTAL
Transcript of Record**

**Appeals from the United States District Court,
Northern District of California,
Southern Division.**

EXHIBIT No. 23-A

In the District Court of the United States for the
Northern District of California Southern Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD
COMPANY,

Debtor.

PETITION OF REORGANIZATION COMMITTEE FOR AN ORDER APPROVING AND AUTHORIZING: INDENTURES RELATING TO FIRST MORTGAGE BONDS AND GENERAL MORTGAGE INCOME BONDS, INCLUDING FORMS OF BONDS, FORM OF INTEREST COUPON AND FORMS OF TRUSTEE'S CERTIFICATES OF AUTHENTICATION; ADJUSTMENT PAYMENTS TO PERSONS TO WHOM NEW SECURITIES ARE ISSUABLE IN RESPECT OF THE PERIOD JANUARY 1, 1939, TO DECEMBER 31, 1943, INCLUSIVE; THE AGGREGATE PRINCIPAL AMOUNT OF GENERAL MORTGAGE INCOME BONDS TO CONSTITUTE SERIES A, THE AGGREGATE PAR VALUE OF THE SHARES OF PREFERRED STOCK TO CONSTITUTE SERIES A, AND ADJUSTMENTS IN THE AGGREGATE AMOUNT OF SAID BONDS AND THE

AGGREGATE PAR VALUE OF SAID STOCK TO BE ISSUED UNDER THE PLAN; THE DENOMINATION OR PAR VALUE, RESPECTIVELY, OF GENERAL MORTGAGE INCOME BOND SCRIP OF SERIES A AND PREFERRED STOCK SCRIP OF SERIES A; AND ADJUSTMENTS IN THE AMOUNT OF GENERAL MORTGAGE INCOME BONDS OF SERIES A AND PREFERRED STOCK OF SERIES A TO BE ISSUED TO THE RAILROAD CREDIT CORPORATION AND A. C. JAMES CO.

Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, being all the members of the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, hereby represent to the Court and petition as follows:

1. The plan of reorganization of the debtor (hereinafter called "the plan") confirmed by order of this Court on October 11, 1943, provides in subdivision R. as follows:

"The plan may be carried out either by re-vesting the properties formerly of the debtor in the debtor company or by transferring said properties to a new corporation organized for the purpose, and the execution by the corporation in which said properties are vested of the new mortgages and the issue by it of the new securities contemplated by the plan.

“The method of carrying out the plan shall be determined by the reorganization committee in its discretion, and the reorganization committee shall also determine, subject to the approval of the court, the form, and, except as herein otherwise expressly provided, the provisions, of all mortgages, bonds, coupons, charters, by-laws, stock certificates, voting trust certificates, acceptances, assents, and all other instruments in the judgment of the reorganization committee necessary or desirable in connection with carrying out the plan.

2. Pursuant to the foregoing provisions of the plan, your petitioners have determined, acting on advice of counsel, that the debtor company should be used in carrying out and making effective the plan of reorganization and should execute the new mortgages and issue the new securities contemplated by the plan. A separate petition is being filed by your petitioners for the approval by this Court of the use of the debtor company.

3. For the purpose of putting into effect and carrying out said plan your petitioners have approved as to substance and general form, and submit herewith for the approval of the Court, the following:

(a) Indenture relating to the First Mortgage Bonds contemplated by the plan, a printer's proof of which is filed herewith as “Exhibit A”;

(b) Indenture relating to the General Mortgage

Income Bonds contemplated by the plan, printer's proof of which is filed herewith as "Exhibit B";

4. The indenture relating to the new First Mortgage Bonds (Exhibit A) contemplates the issuance of bonds of Series A in both coupon and registered form. Said indenture sets forth the form of Series A Coupon Bond, which is in the denomination of \$1,000, the form of interest coupon for Series A Coupon Bonds, the form of Series A Registered Bond, without coupons, and the form of Trustee's Certificate of Authentication, applicable to both forms of bonds. The substance and general form of the foregoing are intended to be included in the submission for approval of the Court hereunder.

5. The indenture relating to the General Mortgage Income Bonds (Exhibit B) contemplates the issuance of bonds of Series A in registered form only. It is contemplated that the bonds of Series A will be issued in denominations of \$100, \$500, \$1,000, \$5,000 and \$10,000, and such other denominations, if any, as may be authorized by the Company, said denominations to be interchangeable except that an exchange may not be made for bonds of a lesser denomination when any such lesser denomination would be less than \$1,000. Said Exhibit B sets forth the form of bond of Series A and the form of Trustee's Certificate of Authentication. The substance and general form of the foregoing are intended to be included in the submission for approval of the Court hereunder.

6. The plan of reorganization of the debtor requires, and the forms of new First Mortgage Bonds, Series A, and of new General Mortgage 4½% Income Bonds, Series A, contemplate that the new bonds distributed under the plan of reorganization shall be dated as of January 1, 1939. Petitioners have determined, subject to the approval of the Court, that the new Preferred Stock, Series A, and the new common stock to be issued upon consummation of the Plan should be dated as of January 1, 1944.

7. The form of indenture for the General Mortgage Income bonds (Exhibit B) submitted to the Court herewith necessarily includes (Sec. 5.03) the determinations made by your petitioners, subject to the approval of the Court, of the "available net income" of the properties of the debtor during the period from January 1, 1939 to December 31, 1943, as required by Subdivision L of the plan of reorganization and the allocation of this income in accordance with the equitable rights under the plan of the participating creditors who will receive the new securities. The plan clearly contemplates that, as between the classes of interested creditors, the available net income of the debtor for any period after January 1, 1939, until the reorganized company comes into ownership and possession of the properties of the debtor shall be treated as if the reorganized company had come into such ownership and possession of the properties on January 1, 1939, and had issued as of that date the new securities is-

suable under the plan, other than the \$10,000,000 First Mortgage Bonds, Series A, and contemplates that for the period after January 1, 1939, until the reorganized company comes into ownership and possession of the debtor's properties, the persons to whom the new securities are issuable shall be entitled to receive appropriate payments in lieu of the interest and dividends to which they would presumably have been entitled under the provisions of the plan, if the plan had been consummated on January 1, 1939.

8. All the securities to be issued in this reorganization will be issued to first mortgage bondholders and secured creditors of the debtor. No provision is made under the plan for unsecured creditors or for owners of preferred or common stock of the debtor company. During the period from January 1, 1939, through the calendar year 1943, the properties of the debtor, which have been under the management of the Trustees appointed by this Court, have shown substantial earnings which would have been available for interest and dividends. The Reorganization Committee, under its duty to carry out the plan pursuant to its terms and intent, and subject to the approval of this Court, has determined that there should be made to said first mortgage bondholders and secured creditors at the time they surrender the obligations of the debtor which they now hold, and receive in satisfaction thereof the new securities authorized under the plan, certain adjustment payments in cash representing the

amounts which said first mortgage bondholders and secured creditors might presumably have received on the new securities which they are to receive under the plan, if such securities had actually been in existence since January 1, 1939, and payments of interest and dividends made thereunder.

9. In determining the amounts of adjustment payments which it is proposed to make, at the time of the consummation of the plan, to carry out the intent of the plan as to recognition as between the various classes of creditors of their equitable right to participate in earnings on the same basis as if the new securities had actually been issued on January 1, 1939, your petitioners have reviewed the earnings records of the properties of the debtor for the period from January 1, 1939, through the calendar year 1943.

10. As reported by the accounting department maintained by the Trustees appointed by this Court, the earnings of the estate of the debtor and its wholly owned railway subsidiaries in the year 1939, after capital fund requirements and before interest (other than equipment trust and trustees' certificate interest), were \$567,407.30, and were therefore such that income in that amount, viz. \$567,407.30 would have been available, under the provisions of the plan, for the payment of interest on the General Mortgage Income Bonds to be issued upon consummation of the plan. The corresponding earnings in the year 1940, amounting to \$1,707,964.93, were such that income in the amount of \$954,855 would have

been available, under the provisions of the plan, for the payment of full interest on the General Mortgage Income Bonds for the year 1940, income of \$387,447.70 for the balance of unpaid interest on such bonds for the year 1939, income of \$106,090 for sinking fund requirements with respect to such bonds for the year 1940, and income in the amount of \$259,572.23 would have been available for the payment of dividends on the preferred stock to be issued upon consummation of the plan or for other corporate purposes. The corresponding earnings in the year 1941, amounting to \$3,650,651.56, were such that sufficient income would have been available, under the provisions of the plan, for the payment of full interest on the General Mortgage Income Bonds, the sinking fund requirement and a dividend of 5% on the preferred stock and after such payments a balance of \$997,196.56 of income available for dividends on the common stock and for other corporate purposes would have remained. The corresponding earnings in the year 1942, amounting to \$9,126,016.98, were such that sufficient income would have been available, under the provisions of the plan, for the payment of full interest on the General Mortgage Income Bonds, the sinking fund requirement and a dividend of 5% on the preferred stock, and after such payments a balance of \$6,472,561.98, of income available for dividends on the common stock and for other corporate purposes would have remained. The corresponding earnings in the year 1943, amounting to \$18,683,299.07, were such that sufficient income would have been available, under

the provisions of the plan, for the payment of full interest on the General Mortgage Income Bonds, the sinking fund requirement and a dividend of 5% on the preferred stock, and after such payments a balance of \$16,029,844.07 of income available for dividends on the common stock and for other corporate purposes would have remained. Attached hereto, as Exhibit "C," is a summary of Available Net Income and Other Data for the period January 1, 1939 to December 31, 1943, inclusive.

11. The above data (paragraph 10) as to earnings after capital fund requirements and before interest (other than equipment trust and trustees' certificate interest) for the period from January 1, 1939 through the calendar year 1943, are subject to the following comments:

(a) The amounts of such earnings for each calendar year are shown after deducting the capital fund requirements, as provided in the plan, without application of the over-all limitation of \$1,000,000, which, as provided in the indenture (Section 5.05) relating to the General Mortgage Income Bonds (Exhibit B) submitted herewith for approval, has been left for adjustment, in respect of the cost of capital investments during the period between January 1, 1939 and December 31, 1943, in the discretion of the directors after the reorganization.

(b) The amounts of such earnings for the calendar years 1942 and 1943 are after deducting deferred maintenance reserves charged to operating ex-

penses, namely, the respective amounts of \$999,082 and \$1,172,542, and amounts for amortization of road defense projects charged to operating expenses, namely, the respective amounts of \$63,840.84 and \$134,412.46.

(c) The amount of such earnings for the calendar year 1943, is before deduction of a special funded tax reserve which has been set up in the amount of \$7,100,000. However, after deduction of such reserve there would still remain the amount of \$11,583,299.07, which would have been available, under the provisions of the plan, for the payment of full interest on the General Mortgage Income Bonds, the sinking fund requirements and a dividend of 5% on the preferred stock, and after such payment a balance of \$8,929,844.07 available for dividends on the common stock and for other corporate purposes would have remained.

(d) The amount of interest upon the General Mortgage Income Bonds and the amount of the preferred stock dividends have been computed upon the aggregate principal or par amounts of such securities contemplated under the plan to be issued in the reorganization, reduced by the minor amounts in respect of the proposed cash payments referred to under paragraph 18 hereinbelow.

(e) The aggregate amount of earnings for the entire period from January 1, 1939, through the calendar year 1943, which would have been available to pay interest to the old first mortgage bondholders and secured creditors was \$35,434,735.76. This

amount is to be compared with the aggregate interest for the period (\$14,437,203.55) which such creditors entitled to participate under the plan would legally be entitled to receive under the obligations of the debtor which they hold but for the provision of the plan as to equitable adjustment on the basis of the new securities to be issued on the consummation of the plan.

(f) The properties of the debtor earned for the years specified below, after all interest and preferred dividends, and available for dividends on the common stock and other proper corporate purposes, the following approximate amounts per share of common stock to be issued under the plan:

Year	Earnings per share
1941	\$ 3.12
1942	\$20.28
1943	\$50.24

In respect of the year 1943, if the special tax reserve, referred to above in subparagraph (c) of this paragraph 11, were to be deducted, the approximate earnings per share would be \$27.99.

(g) The foregoing amounts per share and the aggregate amount set forth in paragraph 13 hereinbelow, have been computed upon the basis of the full number of common shares to be issued in the reorganization, as determined by the decision of this Court construing the plan, dated June 21, 1944, namely, 319,032,767 shares. This number is sub-

ject to reduction in respect of the number of shares to be issued to The Railroad Credit Corporation depending upon the amount of payments to that Corporation under the marshalling and distributing plan of 1931 which amount cannot be finally determined until the time of the consummation of the reorganization.

12. In the reports of October 10, 1938, and June 21, 1939, filed by the Interstate Commerce Commission in connection with this reorganization, the Commission has clearly expressed its desire and purpose that the new financial structure should include only such an amount of common stock as might permit reasonable dividends (sometimes specified as \$3.00 per share) to be earned and paid thereon under normal conditions. The properties of the debtor earned, during the five-year period from January 1, 1939 to December 31, 1943, after interest, capital fund, sinking fund and preferred stock dividends under the new capital structure, an aggregate amount equal to approximately \$73.66 per share on the proposed new common stock. However, these earnings available for common stock dividends and other corporate purposes occurred entirely in the years 1941, 1942 and 1943. The plan provides that not more than \$3.00 per share with respect to any one year shall be paid to the common stockholders of the reorganized company without additional participation by the preferred stockholders.

13. After full consideration of the purpose and intent of the plan, your petitioners have determined

and recommend to the Court for approval that an aggregate amount of \$12,684,271.54 be paid to the present first mortgage and secured creditors, at the time of the consummation of the plan, representing their equitable right as provided in the plan to participate in earnings of the properties during the period from January 1, 1939 through December 31, 1943, to be paid at the time they surrender the obligations of the debtor now held by them for the new securities authorized under the plan.

14. The cash held by the debtor's Trustees is such that, without endangering the cash resources of the reorganized company, such adjustment payments may be made to such bondholders and secured creditors.

15. Petitioners recommend that upon the distribution of the new General Mortgage 4½% Income Bonds, Series A, Preferred Stock, Series A, and common stock, under the provisions of the plan of reorganization, the debtor's Trustees make or cause to be made, through the exchange-depositary to be approved by the Court by one or more checks as may be convenient, adjustment payments in cash as follows:

(a) with each General Mortgage 4½% Income Bond, Series A, issued and distributed under the plan, a cash payment of 22½% of the principal amount thereof;

(b) with each share of Preferred stock, Series A, issued and distributed under the plan, a cash payment of \$15.82; and

(c) with each share of common stock, issued and distributed under the plan, a cash payment of \$9.00.

16. Your petitioners do not recommend that cash payments be made with the scrip certificates for the General Mortgage 4½% Income Bonds or with the scrip certificates for preferred and common stock, but recommend that provision be made for a deposit of sufficient funds with an agent to be approved by the Court for payments corresponding in amounts and percentages to those stated in paragraph 15 hereof, when such scrip is exchanged for General Mortgage 4½% Income Bonds, Preferred Stock and Common Stock, respectively.

17. The plan of reorganization of the debtor provides in subdivision P. for the issuance of a specific amount or number of bonds and shares of stock to the various creditors entitled to participate under the plan. In order to satisfy the requirements, it will be necessary, in the instance of the General Mortgage 4½% Income Bonds, Series A, the Preferred Stock, Series A, and the common stock to be issued under the plan, to provide bond and stock scrip. The form and substance of such scrip will be submitted later for the approval of this Court. At this time, however, your petitioners have determined, subject to the approval of the Court, that the scrip for said bonds and the scrip for said Preferred Stock should be limited in each case to one denomination or par amount; namely, \$20, and that the scrip for said common stock should be for

a number of fractions of a share which would not be fixed but would be filled in when issued with appropriate fractions of not less than thousandths of a share.

18. In the event the denomination and par amount of the foregoing bond and preferred stock scrip are limited to \$20, the requirements of The Railroad Credit Corporation and the A. C. James Co. under subdivision P. of the plan cannot be satisfied exactly by the issuance of such scrip. Furthermore, the aggregate principal amount of Series A bonds to be issued under the plan, namely \$21,219,075, does not enable a complete issuance of bonds in denominations the lowest of which is \$100.00. Similarly the aggregate par value of the Series A Preferred Stock to be issued under the plan, namely, \$31,850,297, does not enable a complete issuance of full shares where as in this instance the par value is \$100. Accordingly your petitioners propose, subject to the approval of the Court, to provide for the issuance of an aggregate principal amount of General Mortgage $4\frac{1}{2}\%$ Income Bonds, Series A, of \$21,219,000 and for the issuance of Preferred Stock, Series A in the aggregate par value of \$31,850,200. Your petitioners have determined in this connection, subject to the approval of the Court, that the aggregate principal amount of Series A of said bonds should be fixed at the amount of \$21,219,000, the amount shown in the indenture relating to said bonds (Exhibit B) and that the total number of shares in Series A of said preferred stock should be

fixed at 318,502 shares. Your petitioners propose, further, subject to the approval of the Court, to make the necessary adjustments, so that the total amount of said Series A Bonds and the total par value of said Series A Preferred Stock issued to all claimants under the plan (including bonds and stock issued to cover scrip) will equal the foregoing aggregate principal and par amounts, by reducing the amount of Series A Bonds and Series A Preferred Stock to be issued to The Railroad Credit Corporation and the A. C. James Co., with payments of the difference in cash as follows:

	Income Bonds		Preferred Stock		Total
	Per Plan	Proposed	Per Plan	Proposed	Cash
The Railroad Credit Corporation	\$154,111	\$154,080	\$241,681	\$241,640	in stock
		in bonds			
		31 in cash		41 in cash	\$ 72
A. C. James Co.	\$163,724	\$163,680	\$256,756	\$256,700	in stock
		in bonds			
		44 in cash		56 in cash	100
					<hr/> \$172

Wherefore, your petitioners pray for the order of this Court:

(a) Approving, in substance and general form, the Indenture relating to the First Mortgage Bonds contemplated by the plan of reorganization of the debtor, a printer's proof of which is filed herewith as "Exhibit A," subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(b) Approving, in substance and general form,

the Indenture relating to the General Mortgage Income Bonds contemplated by the plan of reorganization of the debtor, a printer's proof of which is filed herewith as "Exhibit B," subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(c) Approving in substance and general form, the bonds, interest coupon and trustee's certificates of authentication, the forms of which are set forth in said Exhibits "A" and "B," subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

(d) Approving the recommendation of your petitioners that First Mortgage Bonds, Series A, and General Mortgage 4½% Income Bonds, Series A, to be issued pursuant to the plan, be dated as of January 1, 1939, and that Preferred Stock, Series A, and common stock, to be issued pursuant to the plan, be dated as of January 1, 1944;

(e) Approving the recommendation of your petitioners, and directing the Trustees of the debtor's estate, at the time of the consummation of the plan, to make the adjustment payments in cash, set forth in paragraphs 15 and 16 hereof, in the aggregate amount of \$12,684,271.54;

(f) Approval of the fixing of the aggregate principal amount of Series A of the General Mortgage Income Bonds at the amount of \$21,219,000 and the total number of shares in Series A of the Preferred Stock at 318,502 shares, and the issuance of only

said aggregate principal amount of said bonds and said total number of shares of said stock in fulfillment of the requirements of the plan of reorganization of the debtor.

(g) Approving the issuance of scrip in respect of General Mortgage 4½% Income Bonds, Series A and scrip in respect of Preferred Stock, Series A, only in denomination and par value, respectively, of \$20, and the issuance of scrip with respect to common stock in the form of open or blank denomination to be filled in when issued with appropriate fractions of not less than thousandths of a share.

(h) Approval of the adjustments in the amount of General Mortgage Income Bonds and Preferred Stock to be issued to The Railroad Credit Corporation and A. C. James Co. and the cash payments to said creditors as proposed in paragraph 18 hereof.

(i) Granting such other and further relief as may be proper in the premises.

Respectfully submitted,

WHITMAN, RANSOM,
COULSON & GOETZ,

/s/ WHITMAN, RANSOM,
COULSON & GOETZ,

/s/ PILLSBURY, MADISON,
SUTRO,

Counsel for Petitioners.

State of New York,
County of New York—ss.

Robert E. Coulson, being duly sworn, deposes and says:

That he is a member of the Reorganization Committee of The Western Pacific Railroad Company; that he has read the foregoing petition and knows the contents thereof and the same is true of his own knowledge, except as to the matters which are therein stated to be alleged on information and belief and that as to those matters he believes it to be true.

/s/ ROBERT E. COULSON.

Sworn to before me this 18th day of August, 1944.

[Seal): /s/ BEATRICE C. CUNNINGHAM,
Notary Public, New York County, N. Y. Co. Clk's
No. 212 Reg. No. 426C6, Kings Co. Clk's No. 173
Reg. No. 319C6, Bronx Co. Clk's No. 38 Reg.
No. 140C6, Queens Co. Clk's No. 757 Reg. No.
20906, Certificate filed in Richmond County.

Commission Expires March 30, 1946.

Original Filed U.S.D.C. August 23, 1944.

EXHIBIT No. 23-B

In the District Court of the United States for the
Northern District of California Southern Division

No. 26591-S

In the Matter of

THE WESTERN PACIFIC RAILROAD
COMPANY,

Debtor.

ORDER APPROVING AND AUTHORIZING
MORTGAGE INDENTURES, FORMS OF
BONDS, INTEREST COUPONS, ETC.; AD-
JUSTMENT PAYMENTS TO PERSONS
TO WHOM NEW SECURITIES ARE ISSU-
ABLE UNDER THE PLAN AND OTHER
MATTERS

The petition filed August 23, 1944, by Frederick H. Ecker, Frank C. Wright and Robert E. Coulson, the Reorganization Committee designated to put into effect and carry out the plan of reorganization of the debtor above named, for an order approving and authorizing: indentures relating to First Mortgage Bonds and General Mortgage Income Bonds, including forms of Bonds, form of Interest Coupon and forms of Trustees' Certificates of Authentication; adjustment payments to persons to whom new securities are issuable in respect of the period January 1, 1939 to December 31, 1943, inclusive; the

aggregate principal amount of General Mortgage Income Bonds to constitute Series A, the aggregate par value and number of shares of Preferred Stock to constitute Series A, and adjustments in the aggregate amount of said bonds and the aggregate par value of said stock to be issued under the plan; the denominations, respectively, of General Mortgage Income Bond Scrip of Series A, Preferred Stock Scrip of Series A, and Common Stock Scrip; and adjustments in the amount of General Mortgage Income Bonds of Series A and Preferred Stock of Series A to be issued to The Railroad Credit Corporation and A. C. James Co., duly came on to be heard and was heard September 25, 1944, and has been submitted.

The Court being fully advised in the premises finds that notice of the hearing upon said petition has been given as prescribed by the order of this Court dated and filed August 23, 1944, and that all of the allegations and representations contained in the petition are true except for certain minor corrections made and noted at the hearing on September 25, 1944. The Court further finds and concludes:

(a) The proposed indenture relating to the First Mortgage Bonds contemplated by the plan (Exhibit "A" filed with the petition), with the corrections and changes submitted by petitioners at the hearing on September 25, 1944, and the denomination and form of Series A Coupon Bond, the form of Interest Coupon for Series A Coupon Bonds, the form of Series A Registered Bond without coupons, and

the form of Trustee's Certificate of Authentication applicable to both forms of bonds, all as set forth in said Exhibit "A," are consistent with the plan of reorganization and appropriate for carrying out and making effective the plan and should be approved;

(b) The proposed indenture relating to the General Mortgage Income Bonds contemplated by the plan (Exhibit "B" filed with the petition), with the corrections and changes submitted by petitioners at the hearing on September 25, 1944, and the denominations and form of Series A Registered Bond and the form of Trustee's Certificate of Authentication set forth in said Exhibit "B," are consistent with the plan of reorganization and appropriate for carrying out and making effective the plan and should be approved;

(c) The mortgage indentures should be dated as of January 1, 1939, as provided in the plan of reorganization; the First Mortgage Bonds, Series A, should be dated as of January 1, 1939; the General Mortgage 4½% Income Bonds, Series A, should be dated as of January 1, 1939; and the new Preferred Stock, Series A, and the new common stock to be issued upon consummation of the plan should be dated as of January 1, 1944;

(d) The available net income of the debtor and its subsidiaries for the years 1939 to 1943, inclusive, determined under the provisions of Subdivision L of the plan, is as follows:

1939	\$ 1,017,478.91
1940	2,156,001.35
1941	4,093,588.31
1942	9,484,368.12
1943	18,703,511.00

Total\$35,454,947.69

Upon the consummation of the plan an amount equivalent to such available net income should be applied as directed in ordering paragraphs 5 and 6 hereinbelow;

(e) The cash held by the debtor's Trustees is such that, without endangering the cash resources of the reorganized company, the adjustment payments recommended by the Reorganization Committee may be made to the existing first mortgage bondholders and secured creditors of the debtor;

(f) The determination and recommendation of the Reorganization Committee that adjustment payments in cash in the aggregate amount of approximately \$12,681,086.52 be made to the present first mortgage bondholders and secured creditors of the debtor at the time of the consummation of the plan, are in accordance with the plan of reorganization and appropriate and should be approved; and payments corresponding in amounts and percentages to those recommended in paragraph 15 of the petition should also be made at the time of the consummation of the plan with the scrip certificates issued for General Mortgage 4½% Income Bonds, Series

A, Preferred Stock, Series A, and Common Stock, to the nearest cent in the case of each such bondholder and secured creditor;

(g) The determination and recommendation of the Reorganization Committee that the scrip certificates for General Mortgage 4½% Income Bonds, Series A, and the scrip certificates for Preferred Stock, Series A, be issued only in denominations of \$20 and one-fifth of a share, respectively, and that the scrip certificates for common stock should be for a fraction of a share which would not be fixed but would be filled in when issued with appropriate fractions of not less than thousandths of a share, are consistent with the plan of reorganization and appropriate and should be approved;

(h) The determination and recommendation of the Reorganization Committee that the aggregate principal amount of General Mortgage 4½% Income Bonds, Series A, to be issued in the reorganization be fixed at \$21,219,000, that the aggregate par value of Preferred Stock, Series A, to be issued in the reorganization be fixed at \$31,850,200, under the provisions of the plan, and that a cash payment of \$72 be made to The Railroad Credit Corporation and a cash payment of \$100 be made to A. C. James Co., with corresponding reductions in the aggregate amounts of said bonds and stocks to avoid the issuance of such bonds in denominations of less than \$100 and of fractional shares of such preferred stock, are consistent with the plan and appropriate and should be approved.

Now, Therefore, It Is Hereby Ordered, Adjudged and Decreed

1. That the indenture relating to the First Mortgage Bonds contemplated by the plan of reorganization (Exhibit "A" filed with the petition), with the corrections and changes submitted by the petitioners at the hearing on September 25, 1944, and the form and denomination of Series A Coupon Bond, the form of Interest Coupon for Series A Coupon Bonds, the form of Series A Registered Bond without coupons, and the form of Trustee's Certificate of Authentication, all as set forth in said Exhibit "A," be and hereby are approved as to substance and general form subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

2. That the indenture relating to the General Mortgage Income Bonds contemplated by the plan of reorganization (Exhibit "B" filed with the petition) with the corrections and changes submitted by petitioners at the hearing on September 25, 1944, and the form and denomination of Series A Registered Bond and the form of Trustee's Certificate of Authentication set forth in said Exhibit "B," be and hereby are approved as to substance and general form subject to such minor changes as the Reorganization Committee, upon advice of counsel, may deem advisable;

3. That the determination and recommendation of the Reorganization Committee that First Mortgage Bonds, Series A, be dated as of January 1,

1939, that General Mortgage 4½% Income Bonds be dated as of January 1, 1939, and that Preferred Stock, Series A, and the common stock to be issued pursuant to the plan be dated as of January 1, 1944, be and hereby are approved;

4. That the issuance of scrip certificates in respect of General Mortgage 4½% Income Bonds, Series A, and scrip certificates in respect of Preferred Stock, Series A, only in denominations, respectively, of \$20 and one-fifth of a share, and the issuance of scrip certificates with respect to common stock in the form of open or blank denomination to be filled in when issued with appropriate fractions of not less than thousandths of a share, be and hereby are approved;

5. That the Trustees of the debtor's estate be and hereby are directed to make or cause to be made at the time of the consummation of the plan, through the exchange depositary to be approved by the Court, in such manner as may be convenient, adjustment payments in cash, in the aggregate amount of \$12,681,086.52, or such lesser or greater amount as may be required to make payments to individual creditors to the nearest cent, and in such individual amount or amounts as shall equal the total of or each of the following, as the Reorganization Committee may determine:

(a) with each General Mortgage 4½% Income Bond, Series A, issued and distributed under the plan, a cash payment of 22½% of the principal amount thereof;

(b) with each share of Preferred Stock, Series A, issued and distributed under the plan, a cash payment of \$15.81;

(c) with each share of common stock, issued and distributed under the plan, a cash payment of \$9.00; and

(d) with scrip certificates for General Mortgage 4½% Income Bonds, Series A, Preferred Stock, Series A, and common stock, issued and distributed under the plan, payments corresponding in amounts and percentages to those directed in this paragraph to be made with such Bonds, Preferred Stock and common stock, respectively;

6. That the balance of the available net income of the debtor and its subsidiaries for the years 1939 to 1943, inclusive, remaining after the payments directed in paragraph 5 hereof, be applied as follows:

(a) \$1,699,395.92 to be credited by the reorganized company to the capital fund account within thirty days after the consummation of the plan, provided, however, that such account shall be reduced prior to or at the end of such thirty-day period to \$1,000,000 either by proper charges to such account, under the provisions of the plan, or by reducing said account by the amount of the excess over \$1,000,000;

(b) \$424,360 to be applied to the making of the sinking fund payments required by subdivision L of the plan in respect of the General Mortgage 4½% Income Bonds, Series A; and

(c) \$20,659,938.92, or the remaining balance of said available net income, to be applied to any proper corporate purpose of the reorganized company;

7. That the aggregate principal amount of Series A of General Mortgage Income Bonds be fixed at \$21,219,000, and that the total number of shares in Series A of the Preferred Stock be fixed at 318,502 shares of the par value of \$100 each, and that \$21,219,000 principal amount of said bonds and 318,502 shares of said Preferred Stock be issued in fulfillment of the requirements of the plan of reorganization:

8. That The Railroad Credit Corporation receive, in fulfillment of the requirements of paragraph 4 of Subdivision P of the plan of reorganization, \$154,080 General Mortgage 4½% Income Bonds, Series A, \$241,640 Preferred Stock, Series A, not more than 35,425 shares of common stock and cash in the amount of \$72.00; and

9. That A. C. James Co. receive, in fulfillment of the requirements of paragraph 5 of Subdivision P of the plan of reorganization, \$163,680 General Mortgage 4½% Income Bonds, Series A, \$256,700 Preferred Stock, Series A, 37,635 shares of common stock and cash in the amount of \$100.00.

Dated Sept. 25, 1944.

/s/ A. F. ST. SURE,
District Judge.

[Endorsed]: Filed April 6, 1949.

[Endorsed]: No. 12506. United States Court of Appeals for the Ninth Circuit. Western Pacific Railroad Corporation and Alexis I. duP. Bayard, Receiver, Appellants, vs. Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, the Western Realty Company, the Standard Realty and Development Company and Delta Finance Co., Ltd., Appellees. Meredith H. Metzger, Henry Offerman and J. S. Farlee & Co., Inc., Appellants, vs. Western Pacific Railroad Company, Sacramento Northern Railway, Tidewater Southern Railway, Deep Creek Railroad Company, the Western Realty Company, the Standard Realty and Development Company and Delta Finance Co., Ltd., Appellees. Supplemental Transcript of Record. Appeals from the United States District Court for the Northern District of California, Southern Division.

Filed March 20, 1950.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth Circuit.

No. 12,506

IN THE

United States

Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. duP. BAYARD, Receiver,

Plaintiffs and Appellants,

and

MEREDITH H. METZGER, HENRY OFFERMAN and J. S.
FARLEE & CO., INC., a corporation,

Interveners and Appellants,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER SOUTHERN
RAILWAY, DEEP CREEK RAILROAD COMPANY, THE
WESTERN REALTY COMPANY, THE STANDARD REALTY
AND DEVELOPMENT COMPANY and DELTA FINANCE
CO., LTD.,

Defendants and Appellees.

Opening Brief of Appellants

The Western Pacific Railroad Corporation
and Alexis I. duP. Bayard, Receiver

HERMAN PHLEGER,
MAURICE E. HARRISON,
MOSES LASKY,
BROBECK, PHLEGER & HARRISON,
111 Sutter Street, San Francisco 4, Calif.

FRANK C. NICODEMUS, JR.,
44 Wall Street, New York 5, N. Y.

A. PERRY OSBORN,
20 Exchange Place, New York 5, N. Y.

NORRIS DARRELL,
48 Wall Street, New York 5, N. Y.

MAHLON DICKERSON,
120 Broadway, New York 5, N. Y.

LeROY R. GOODRICH,
Bank of America Building, Oakland 12, Calif.

Attorneys for Appellant

The Western Pacific Railroad Corporation.

HERMAN PHLEGER,
MAURICE E. HARRISON,
MOSES LASKY,
BROBECK, PHLEGER & HARRISON,
111 Sutter Street, San Francisco 4, Calif.

Attorneys for Appellant

Alexis I. duP. Bayard, Receiver.

SUBJECT INDEX

	Page
Chronology	Flyleaf
Jurisdiction	1
Statement of the Case.....	2
I. Nature of the case.....	2
How the tax benefit was obtained.....	4
The date of loss, and the economic severance.....	6
II. The Operating Company conceived the tax saving, took over and handled the tax affairs of plaintiff Corporation, appropriated plaintiff's tax credits in order to accomplish the tax saving, and ignored its fiduciary relation to plaintiff in refusing to account	8
Findings	8
Summary of the facts.....	9
The plaintiff's stunned condition.....	10
Plaintiff's lack of independent representation:— Duality and the duality chart.....	11
Messrs. Coulson and Polk.....	13
Mr. Coulson introduced himself into the parties' tax matters, February 1943, and his firm became tax counsel for the defendant March 1943.....	14
The plaintiff corporation was under no duty to file consolidated returns.....	15
1942 tax returns.....	16
The 1943 returns: The decision to use plaintiff's stock loss was made by defendant.....	17
1942 refund claim based on carry-back of plaintiff's loss.....	18
1944 tax returns: Mr. Curry in Mr. Coulson's office.....	19
The power of attorney and the settlement with the Government	20
Coulson and Polk never advised plaintiff of its rights.....	24

	Page
Plaintiff learns of the use of its stock loss and files this suit in 1946.....	24
Stipulation of August 1947, pretrial order, and supplemental complaint.....	24
III. Other relevant facts.....	25
Transmutation of the defendant Operating Company.....	25
Consummation of the reorganization.....	26
The \$10,100,000 reserve fund to pay the taxes.....	27
The Operating Company after reorganization.....	28
Specification of errors relied upon.....	28
The legal question presented and the trial court's decision.....	29
Summary of the argument.....	30
Argument	34
I. Plaintiff is entitled to recover under the equitable principles of unjust enrichment.....	34
The Shreveport Bank cases.....	36
A. The retention of the benefits received by defendant would be unjust for two major reasons. The first reason is that such retention is inconsistent with the rationale and purposes of consolidated returns.....	39
The law and regulations concerning joinder in consolidated returns by one in receivership or bankruptcy.....	43
S.E.C. decisions	43
The trial court recognized the injustice of defendant's keeping the tax savings and yet for that very reason denied plaintiff recovery.....	47
Plaintiff's right to recover is supported by elementary equitable rules of contribution.....	47
B. Retention of the benefits received by defendant would be unjust because plaintiff was under no duty to confer on defendant the benefit of its loss, and defendant, occupying a fiduciary relation to the plaintiff, appropriated that loss to its own use.....	51

Plaintiff was under no duty to join in consolidated returns
or to confer on defendant the benefit of its tax credits 51

Defendant, in a position of dominance, appropriated
plaintiff's loss and is subject to the obligations of a
fiduciary 55

As a fiduciary, defendant must account for benefits gained 61

Duality 64

C. Plaintiff's right to recover rests on benefits conferred and is
not confined to detriment sustained..... 66

The right to recover does not require a contract..... 75

II. The trial court's reasons for denying relief to plaintiff are er-
roneous 76

A. It was improper to deny relief to plaintiff on the belief that
the tax saving ought not to have been allowed by the Treasury 78

The tax procedure and deductions were in accord with the
law 78

Whether the tax saving should have been allowed by the
Treasury was no issue in this case..... 79

Even if the tax deductions were improper, that would be
no reason to deny relief to plaintiff..... 82

The District Court did not apply its own theory con-
sistently 87

B. Plaintiff is not seeking to go behind the Reorganization Plan 88

Conclusion 96

Appendix One

Appendix Two

Chart, Plaintiff's Exhibit 1: Corporate Relationships Chart.

Chart, Plaintiff's Exhibit 2A: Duality Chart.

TABLE OF AUTHORITIES CITED

CASES	Pages
Addison v. Holly Hill Co., 322 U.S. 607.....	34n
Alameda Investment Co., et al. v. McLaughlin, 28 F.2d 81 (D.C.N.D. Cal.), aff'd 33 F.2d 120 (9 Cir.).....	40
Bancokentucky Co.'s Receiver v. National Bank etc., 137 S.W.2d 357 (Ky.)	61
Bankers Trust Company v. Florida East Coast Car Ferry Co., 92 F.2d 450 (5 Cir.).....	48, 49
Barney v. Saunders, 16 How. (U.S.) 534.....	61, 84
Benton v. Callaway, 165 F.2d 877 (4 Cir.).....	52, 93
Bernheim v. Louisville Property Co., 214 S.W. 801 (Ky.).....	66
Berry, In re, 147 Fed. 208 (2 Cir.).....	91
Bigelow, et al. v. R.K.O. Radio Pictures, 327 U.S. 251.....	74
Boom Company v. Patterson, 98 U.S. 403.....	73
Boston and Lowell Railroad Corporation v. Salem and Lowell Rail- road Co., et al., 2 Gray 1 (Mass. 1854).....	75n
Botany Worsted Mills v. United States, 278 U.S. 282.....	23, 88
Brayton v. Welch, 39 F. Supp. 537.....	55
Brooks v. Martin, 2 Wall. 70.....	58
Bull v. United States, 295 U.S. 247.....	80, 81
Callaway v. Benton, 336 U.S. 132.....	52, 89, 93
Carpenter v. Southworth, 165 Fed. 428.....	91
Chelrob v. Barrett, 57 N.E.2d 825 (N.Y.).....	64, 65
Commercial Nat. Bank in Shreveport v. Connolly, 176 F.2d 1004 (5 Cir.).....	36, 38, 56, 59, 63, 69, 73, 76, 84
Commercial Nat. Bank in Shreveport v. Parsons, 144 F.2d 231 (5 Cir.), cer. den. 323 U.S. 796.....	37, 38, 56, 59, 60, 63, 69, 73, 76, 84
Commissioner v. Korell, 339 U.S. (prelim. print) 619.....	79
Commissioner of Internal Revenue v. Owens, 78 F.2d 768 (10 Cir.)	57
Connolly v. Commercial Nat. Bank in Shreveport, 72 F. Supp. 961 38, 56, 59, 63, 69, 73, 76, 84	
Consolidated Electric and Gas Company, In the Matter of, 13 S.E.C. Decisions and Reports, 649.....	46, 47, 54
Consolidated Electric and Gas Company, In the Matter of, 15 S.E.C. Decisions and Reports, 161.....	44, 54, 69

TABLE OF AUTHORITIES CITED

v

Pages

Daniel v. Daniel, 198 Pac. 728 (Wash.).....	86
DeMartin v. Phelan, 115 Cal. 538.....	59
Duke Power Co. v. Commissioner of Internal Revenue, 44 F.2d 543 (4 Cir.), cer. den. 282 U.S. 903.....	40, 51
Ecker v. Western Pacific R. Corp., 318 U.S. 448.....	4n
Edwards v. Lee's Administrators, 96 S.W.2d 1028 (Ky.).....	69, 73
Epstein, In re, 4 F.2d 529 (6 Cir.).....	80
Eshleman v. Keenan, 187 Atl. 25, 2 A.2d 904 (Del.).....	64n
Fleishhacker v. Blum, 109 F.2d 543 (9 Cir.).....	62
Galbraith v. Devlin, 148 Pac. 589 (Wash.).....	81
Geddes v. Anaconda Copper Mining Co., 254 U.S. 590.....	64n
George A. Fuller Co. v. Commission of Internal Revenue, 92 F.2d 72 (2 Cir.).....	79
Gillig v. Grant, 49 N.Y. Supp. 78.....	91
Globe Woolen Company v. Utica Gas & Electric Co., 121 N.E. 378 (N.Y.)	64n
Goodell v. Verdugo Canon Water Co., 138 Cal. 308.....	64n
Greene County Nat. Farm Loan Assn. v. Federal Land Bank, 57 F. Supp. 783	55, 56
Handy & Harman v. Burnet, 284 U.S. 136.....	39
Helvering v. Morgan's, Inc., 293 U.S. 121.....	41
Humboldt Sav. Bank v. McCleverty, 161 Cal. 285.....	34
In re Berry, 147 Fed. 208 (2 Cir.).....	91
In re Epstein, 4 F.2d 529 (6 Cir.).....	80
In re Kaufman's Estate, 10 N.Y.S. 2d 616.....	81
In re Mayer's Estate, 22 N.Y.S. 2d 468.....	81
In re Rahn's Estate, 291 S.W. 120 (Mo.).....	87n
In re Western Pacific R. Co., 124 F.2d 136 (9 Cir.).....	4n, 95
In the Matter of Consolidated Electric and Gas Company, 13 S.E.C. Decisions and Reports 649.....	46, 47, 54, 69
In the Matter of Consolidated Electric and Gas Company, 15 S.E.C. Decisions and Reports 161.....	41, 54
In the Matter of Missouri Pacific Railroad Company, Debtor (U.S. D.C. E.D. Mo.), July 29, 1947, No. 6935.....	54

	Pages
James' Estate, Re, 86 N.Y.S. 2d 78 (1948).....	66
James v. Campbell, 104 U.S. 356.....	73
J. D. & A. B. Spreckels Co., 41 B.T.A. 370.....	42, App. 1
Johnston v. 20th Century-Fox Film Corp., 82 C.A.2d 796.....	75
Kaufman's Estate, In re, 10 N.Y.S. 2d 616.....	81
Kochorimbus v. Maggos, 154 N.E. 235 (Ill.).....	58n
Koppers Co., 8 T.C. 886.....	50
Koppers Co., 11 T.C. 894.....	50
Langley v. Devlin, 163 Pac. 395 (Wash.).....	81n
Leslie v. Commercial Nat. Bank in Shreveport, 28 F. Supp. 927	
36, 56, 59, 63, 69, 73, 76, 84	
McBlair v. Gibbes, 17 How. (U.S.) 232.....	86
Matarese v. Moore-McCormack Lines, 158 F.2d 631 (2 Cir.).....	74n, 76n
"Kentucky Cave Case": Edwards v. Lee's Adm'r, 96 S.W.2d (Ky.)..	69, 73
Mayer's Estate, In re, 22 N.Y.S. 2d 468.....	81
Mayflower Hotel Stockholders P.C. v. Mayflower Hotel Corp., 173	
F.2d 416 (App. D.C.).....	62
Meinhard v. Salmon, 164 N.E. 545 (N.Y.).....	58, 59
Memphis & Arkansas City Packet Co. v. Agnew, 177 S.W. 949	
(Tenn.)	86r
Merger Mines Corporation v. Grismer, 137 F.2d 335 (9 Cir.), cer.	
den. 320 U.S. 794.....	64r
Metropolis etc. Sav. Bank v. Monnier, 169 Cal. 592.....	61r
Missouri Pacific Railroad Company, Debtor, No. 6935, U.S. D.C.,	
E.D. Mo., July 29, 1947.....	5-
North American Co. v. S.E.C., 327 U.S. 686.....	60
Perrine v. Pennroad Corporation, 47 Atl. 2d 479 (Del.).....	59r
Peyton v. William C. Peyton Corporation, 7 A.2d 737 (Del.).....	6r
Phillips-Jones Corp. v. Parmley, 302 U.S. 233.....	5r
Potter v. Sanitary Co. of America, 194 A. 87 (Del. Ch.).....	6
Price v. Standard Oil Co., 55 N.Y.S. 2d 890.....	64r
Rahn's Estate, In re, 291 S.W. 120 (Mo.).....	87r
Reading v. The King, [1949] 2 K.B. 232, aff'm'g, [1948] 2 K.B.	
268	59, 63, 69, 76, 8
Re James Estate, 86 N.Y.S. 2d 78 (1948).....	6

TABLE OF AUTHORITIES CITED

vii

	Pages
San Diego Land, etc. Company v. Neale, 78 Cal. 63.....	73
"Shreveport Bank Cases," 28 F. Supp. 927; 144 F.2d 191; 72 F. Supp. 961; 176 F.2d 1004.....	36, 37, 38, 56, 59, 60, 63, 69, 73, 76, 84
Southern Pacific Co. v. Bogert, 250 U.S. 483.....	58, 60
Southern Pacific Company v. Jensen, 244 U.S. 205.....	87
Standard Oil Company v. Hawkins, 74 Fed. 395.....	91
Stephens v. Southern Pacific Company, 109 Cal. 86.....	87
Thompson v. Terminal Shares, Inc., 104 F.2d 1 (8 Cir.), cer. den. 308 U.S. 559.....	52
Trinity Buildings Corporation of New York, 40 B.T.A. 1315.....	79
Truncale v. Universal Pictures, Inc., 76 F. Supp. 465.....	54, 71, 72, 73
U. S. v. Pierce Auto Lines, 327 U.S. 515.....	80
U. S. v. Willow River Co., 324 U.S. 499.....	74
Western Pacific R. Co. Reorganization, 233 I.C.C. 409....	3n, 25, 90, 91, 92
Western Pacific R. Co., In re, 124 F.2d 136 (9 Cir.).....	4n, 95
Westinghouse Company v. Wagner Mfg. Co., 225 U.S. 604.....	74
Whiting v. Hudson Trust Company, 138 N.E. 33 (N.Y.).....	55
Wolters v. Henningsan, 114 Cal. 433.....	50
Woolford Realty Co. v. Rose, 286 U.S. 319.....	41
Young v. Higbee Company, 324 U.S. 204.....	63

STATUTES AND REGULATIONS

Bankruptcy Act, Section 77.....	3, 52n, 88, 94
Subd. (a).....	52n
Subd. (e).....	7n
California Civil Code:	
Section 2235.....	61n
Section 3517.....	78
Internal Revenue Code:	
Section 23(g), subsec. 4.....	5n, 43, 78
Section 52.....	43
Section 122(b) (1).....	5
Section 122(b) (2).....	5
Section 141.....	4n, 78
Section 141(b).....	54
Section 3772(2).....	88

	Pages
Public Utility Holding Company Act of 1935.....	
Section 12.....	44
Revenue Act of 1921, Sec. 240(b).....	53n
Revenue Act of 1924, Sec. 240(b).....	53n
Revenue Act of 1926, Sec. 240(b).....	53n
Revenue Act of 1942:	
Section 123(a).....	5n, 89
Section 141(a).....	39n
Securities and Exchange Commission Reg. U-45.....	44
42 Stat. 260.....	53n
43 Stat. 288.....	53n
44 Stat. 825.....	53n
Treasury Regulation 104.....	4n
Section 23.10(b).....	16
Section 23.11(a).....	15, 54
Section 23.15(a).....	54
Section 23.15(b).....	43
Section 23.15(d).....	54
Section 23.16(a).....	15, 24
Treasury Regulation 110.....	4n
United States Code:	
Title 11, Section 205.....	3n
Subd. (a).....	52r
Subd. (e).....	7r
Title 28, Section 1291.....	2
Title 28, Section 1294(1).....	2
Title 28, Section 1332.....	2

TEXTS, TREATISES AND OTHER MATERIAL

American Jurisprudence:

Volume 2, Sec. 268, p. 215.....	6
Volume 54, p. 249.....	6

3 Bogert on Trusts (Part 1):

p. 78.....	5
p. 79.....	6
p. 80.....	58

TABLE OF AUTHORITIES CITED

ix

	Pages
p. 82.....	59
p. 83.....	59
p. 153.....	63
p. 156.....	63
2 Bouvier's Law Dictionary (Rawle's Revision), Title, Quasi-Contractus, P. 803.....	57, 76
Brandeis, Louis, and Warren, Samuel, "The Right to Privacy," 4 Harv. Law. Rev. 193 (1890), pp. 193-5, 212.....	75
69 Congressional Record 653.....	App. 1
5 Collier on Bankruptcy (14th ed.) p. 497.....	52n
3 C.J.S. Section 165, p. 53.....	62
p. 54.....	68
3 Fletcher Cyc. Corporations (Perm. ed.) Sec. 961, pp. 433, 434....	64
Glenn on Liquidation, p. 833.....	91
Justinian's Institutes (Sandar's Edition)	
Liber III, Tit. XXVII, p. 385.....	57
Maitland's Equity, p. 83.....	61
II Montgomery Federal Taxes, Corporations and Partnerships, 1946-1947 issue:	
p. 632.....	39n
p. 633.....	39
p. 649.....	15
p. 650.....	15
1 Op. Atty. Gen. 459.....	80
Pomeroy on Equity Jurisprudence (5th ed.) 263.....	61
Pound and Plucknett, Readings on the History and System of the Common Law (3rd ed. 1927), p. 629.....	61
Report of the Senate Finance Committee on the Revenue Bill of 1928, 70th Congress, 1st session, Senate Report 960....	42, App. 1
Report of the Senate Finance Committee on the Revenue Bill of 1932, 72nd Congress, 1st session, Senate Report 665, at p. 9.....	42

	Pages
Restatement of Agency,	
Section 387.....	62
Section 388.....	62
Section 390	66
Section 392.....	66
Restatement of Restitution:	
Section 1.....	35, 67
Comment a.....	35
Comment b.....	35
Comment, pp. 13 and 14.....	67
p. 15.....	68n
Section 81, comment under Sec. 81, sections following, and Introductory Note under Topic 3 at pp. 327, et seq.....	48
Section 136.....	70, 71
Chapter 6.....	71
Page 493.....	71n
Restatement of Trusts:	
Section 170.....	66
Section 203.....	62
Scott on Trusts:	
Vol. 2, p. 1098.....	68
Vol. 2, Sec. 269.3, p. 1520.....	55
Vol. 3, Sec. 502, p. 2422.....	62, 68
3 Story's Equity Jurisprudence (14th ed.), Sec. 1663, p. 303.....	83
1 Williston on Contracts (Rev. ed.), p. 9.....	34n

CHRONOLOGY

(P. Ex. 2B)

1943

- | | |
|----------|--|
| March 15 | Supreme Court approves Plan. |
| March 23 | Coulson firm employed as Tax Counsel. |
| May 15 | 1942 tax returns filed. |
| June 1 | All employees New York office taken over as full time employees of Trustees. |
| Oct. 11 | District Court confirms Plan. |

1944

- | | |
|------------|---|
| January | 1943 tax accruals reversed. Coulson Opinion Letter. |
| April 30 | Affiliation terminated. |
| July 15 | 1943 tax returns filed. |
| Dec. 14-29 | Property revested in Company and Assumption Agreement executed. |

1945

- | | |
|---------|--|
| March 9 | Refund Claim 1942 taxes filed. |
| May 1 | New York offices closed. Curry and Valouch go to Coulson's office. |
| June 15 | 1944 tax returns filed. |

1946

- | | |
|---------|------------------|
| Oct. 10 | This suit filed. |
|---------|------------------|

1947

- | | |
|------------|---------------------------------|
| Feb. 11 | First offer of tax settlement. |
| Aug. 13-26 | Tax settlement with Government. |

No. 12,506

IN THE

United States Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, Receiver,
Plaintiffs and Appellants,
and

MEREDITH H. METZGER, HENRY OFFERMAN
and J. S. FARLEE & CO., INC., a corporation
Intervenors and Appellants,
vs.

THE WESTERN PACIFIC RAILROAD COMPANY,
SACRAMENTO NORTHERN RAILWAY, TIDE-
WATER SOUTHERN RAILWAY, DEEP CREEK
RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND
DEVELOPMENT COMPANY and DELTA FI-
NANCE CO., LTD.,
Defendants and Appellees.

Opening Brief of Appellants

The Western Pacific Railroad Corporation
and Alexis I. duP. Bayard, Receiver

JURISDICTION

This is an appeal from a final judgment of the District Court
of the Northern District of California, Southern Division,

entered January 13, 1950 (324). Notice of appeal was filed February 8, 1950 (326).

The jurisdiction of the District Court was invoked under 28 U.S.C. Sec. 1332. Appellant The Western Pacific Railroad Corporation (plaintiff below) is a Delaware corporation, and the appellees (defendants below) are California corporations, except that The Western Realty Company and Deep Creek Railroad Company are respectively corporations of the States of Colorado and Utah (Complaint, 6; Answers, 12, 117, 118). The appellants Metzger, Offerman and Farlee were interveners below. They were stockholders of plaintiff, presenting no claims of their own, and their interest is identical with that of plaintiff. Appellant Bayard, Receiver, is a citizen of Delaware and was appointed receiver by the Chancery Court of Delaware (292, 293).

The amount in controversy exceeds \$3,000, exclusive of interest and costs (Complaint, 6; Supp. Complaint, 208-231).

The jurisdiction of this Court is invoked under 28 U.S.C. 1291 and 1294(1).

STATEMENT OF THE CASE

I. Nature of the Case

In this action plaintiff The Western Pacific Railroad Corporation seeks to compel the principal defendant to account for a \$17,201,739 federal tax benefit derived from the utilization by that defendant of a right belonging to plaintiff. This benefit was obtained by that defendant by causing consolidated income tax returns to be filed by plaintiff wherein a \$75,000,000 loss incurred by the plaintiff was used to offset the defendant's taxable income. As a consequence, taxes otherwise payable by the defendant were

All emphasis is supplied unless otherwise indicated.

References to pages of the transcript are shown by the page number in parenthesis: ().

Exhibits are indicated thus: Plaintiff's (P); Defendants' (D), the number of the exhibit following the letter.

When the page of the record for an exhibit is given, it is shown by the page number preceding the letter indicating the party whose exhibit it is, with the number of the exhibit following the letter, thus: (P)

discharged. The court below found the amount of the tax benefit which defendant obtained by use of plaintiff's loss to be \$17,201,739 (267). For convenience, this will be referred to as \$17,000,000.

The court entered judgment for the defendant without costs (323-325). It rendered an opinion (258) reported in 85 F. Supp. 868, which it adopted as its findings (319).

Until April 30, 1944, the plaintiff, for convenience called the Corporation, owned all of the capital stock of the principal defendant, The Western Pacific Railroad Company, an operating railroad company, for convenience called the defendant or the Operating Company.¹ For this stock the plaintiff had invested \$75,000,000 in the Operating Company (262).

In 1935, the Operating Company was in financial difficulties, and went in bankruptcy under Section 77 of the Bankruptcy Act,² in proceedings in the court below (1908). Trustees were appointed by the bankruptcy court in September, 1935 (1916), and remained in possession until December 29, 1944 (see p. 26, *infra*). The term "defendant" or "Operating Company" as used in this brief includes the trustees during that period.

In 1939, the Interstate Commerce Commission proposed and approved a plan of reorganization. In this plan the Commission found that the Corporation's stock in the Operating Company was without equity or value and was not entitled to participate in the reorganization.³ The bankruptcy court approved the Com-

¹Six additional defendants are named in the pleadings but for practical purposes may be ignored. Four were wholly owned subsidiary companies of the Operating Company when the tax returns were filed, and all still occupy that status. Another, Western Realty Company, was wholly owned by plaintiff. Its financial stake in this action cannot exceed \$11,240. The seventh defendant was wholly owned by Western Realty and is now wholly owned by the Operating Company.

The corporate relationships of the parties are shown on a chart (P 1). Printing of this exhibit in the record was dispensed with by order of this Court (2175), but it is reproduced at the end of this brief.

²11 U.S.C. 205.

³*Western Pacific R. Co. Reorganization*, 233 I.C.C. 409, 452.

mission plan (1666 P. 8). The Corporation appealed, and on November 28, 1941, this Court reversed the bankruptcy court.⁴ On March 15, 1943, the Supreme Court reversed this Court and affirmed the bankruptcy court's approval of the plan.⁵

By this decision of the Supreme Court, on March 15, 1943, the \$75,000,000 investment of the Corporation in the Operating Company was wiped out.

The Corporation had no other substantial assets, and on October 19, 1949, was placed in receivership in Delaware on petition of the Attorney General of that state (292). On motion of the Corporation (289), the receiver, Alexis I. duP. Bayard, was joined as a party plaintiff in the present case on November 28, 1949 and is one of the appellants (317).

The real parties in interest on the plaintiff's side are its 4,700 stockholders, living all over the United States, more than 1,000 of them in California (659). It was they who had invested \$110,000,000 in its stock,⁶ and it in turn had invested over \$75,000,000 in the stock of the Operating Company.

Any recovery by plaintiff will go to the receiver for the benefit of plaintiff's preferred stockholders.⁷

At the request of the receiver, who joins in this brief, we attach as "Appendix Two" a copy of his preliminary report to the court that appointed him.

HOW THE TAX BENEFIT WAS OBTAINED.

The way in which the Operating Company obtained the \$17,000,000 tax benefit from the use of the Corporation's loss of \$75,000,000 was as follows:

Under the Internal Revenue Code,⁸ a parent company and its

⁴*In re Western Pacific R. Co.*, 124 F.2d 136 (9 Cir.).

⁵*Ecker v. Western Pacific R. Corp.*, 318 U.S. 448.

⁶P 4B, Schedule C; this is one of the exhibits printing of which was dispensed with by order of this Court (2175).

⁷The preferred stock exceeds the amount recoverable in this suit (1717).

⁸Internal Revenue Code, Sec. 141; Treasury Regulation 104, relative to income taxes, and Regulation 110, relative to excess profits taxes.

subsidiaries may file a single consolidated tax return in which losses are offset against gains, and taxes are paid only on the net. By an amendment made in October 1942, a loss due to a stock's becoming worthless could be treated as an operating loss, instead of a capital loss as theretofore, and offset against ordinary income.⁹

By the decision of the Supreme Court on March 15, 1943, the Corporation sustained a \$75,000,000 loss. But at the very instant the Corporation sustained this loss, its financial interest in the Operating Company terminated, and it became a complete economic stranger.

In this state of facts tax counsel of the Operating Company conceived the plan of having the Corporation and Operating Company file consolidated returns in order to set off the Corporation's loss against the Operating Company's income.

This the Operating Company caused to be done.

The Operating Company made large profits in the war years of 1942, 1943 and 1944, at which time the excess profits tax was in effect. Taxable net profits were nearly \$11,000,000 in 1942, over \$18,000,000 in 1943, and in 1944 up to April 30th nearly \$3,000,000 (P 3, 4, 5). And throughout 1943 and the first four months of 1944 moneys were accrued by the Operating Company to meet the expected tax liability in an amount exceeding \$10,500,000 (915 P 56, 1818-1824 P 76).

Consolidated income and excess profits tax returns for 1943 were filed in the Corporation's name on July 15, 1944 (P 4A and 3). They reported the Corporation's huge stock loss sustained in 1943, used \$18,000,000 of it to offset that amount of taxable net income of the Operating Company, and thus reported no net income and no tax due.

The unused portion of the loss could be carried forward and back (I.R.C., Sec. 122(b)(1) and (2)). On March 9, 1945, defendant's tax counsel filed a claim for refund in the name of

⁹Revenue Act of 1942, Sec. 123(a), adding subsection 4 to Section 123(g), I.R.C.

the Corporation to recover the \$4,201,821 paid for the defendant's 1942 taxes (1656, P 6), the basis of the claim being the use as a carryback of over \$10,000,000 of the unused portion of the Corporation's 1943 loss. And on June 15, 1945, defendant's tax counsel filed consolidated returns in the name of the Corporation for the period January 1-April 30, 1944 (P 5A, 5B), offsetting against nearly \$3,000,000 of income of the Operating Company another portion of the Corporation's loss, and no income and no tax due were reported.

In 1947, the taxes were finally settled by agreement with the Treasury Department on the basis of the returns as filed, the 1943 and 1944 taxes being nil, and the claim for refund for 1942 being rejected (see further detail at pp. 20-23, *infra*). The net savings retained by the Operating Company due to the use of the Corporation's stock loss were, as found by the court below, \$17,201,739 (267).

It is of these savings, obtained through the use of the Corporation's stock loss, that the Corporation seeks an accounting.

The question before this Court is whether the Corporation, and its stockholders who provided the capital which was lost, are entitled to the benefit obtained by the Operating Company through its use of that loss.

THE DATE OF LOSS, AND THE ECONOMIC SEVERANCE.

Following the Supreme Court's decision on March 15, 1943, the Reorganization Plan was confirmed by the Bankruptcy Court on October 11, 1943 (1674 P 10). The economic unity which had previously existed between the Corporation and the Operating Company was severed forever, and they became economic strangers. The proprietary interest of the Corporation in Operating Company was at an end; the community of economic interest was over.

But for all practical purposes the Supreme Court's decision marks the date of the loss. It then became the duty of the District Court (in the absence of some unusual circumstances) to confirm the plan if the requisite percentage of creditors should

vote in favor of it and probably even if they did not.¹⁰ The James Interests, the largest stock interest in both the Corporation and the Operating Company (1717 P 17, 18), had previously fought the Plan and sought to maintain the Corporation's equity in the Operating Company.¹¹ But immediately after the Supreme Court's decision the James Interests decided to support the Plan and entered into an agreement with other major creditors to work wholeheartedly for its prompt consummation (577, 578, 618).

For income tax purposes it is irrelevant whether the date of plaintiff's loss is March or October, 1943, for in either event it is a 1943 loss. For the purpose of fixing the relative rights, duties and obligations of the parties, the date of March 15, 1943 (the Supreme Court decision) is important. Before then the Corporation as the owner of all of the stock of the Operating Company, and as the hopeful petitioner for the continuance of that ownership after reorganization, was benefited by any benefit that accrued to the Operating Company. After the Supreme Court decision, everyone having to do with the affairs of the Corporation was under the highest obligation to see that its rights, and the rights of its stockholders, were not dissipated, lost, violated or neglected. From that date those persons who, with propriety, had heretofore acted in dual capacities or as joint officers of the Corporation and Operating Company were now under the highest obligation to see that no act and no inaction of theirs should prejudice the rights of either company against the other.

¹⁰Bankruptcy Act, Sec. 77(e); 11 U.S.C. Sec. 205(e).

¹¹For the identity of the James Interests, cf. p. 13, *infra*, and chart, 1, reproduced at the end of this brief.

II. The Operating Company Conceived the Tax Saving, Took Over and Handled the Tax Affairs of Plaintiff Corporation, Appropriated Plaintiff's Tax Credits in Order to Accomplish the Tax Saving, and Ignored Its Fiduciary Relation to Plaintiff in Refusing to Account.

The foregoing are the bare facts showing how the Operating Company received a benefit of \$17,000,000 through the use of the plaintiff's loss. Under principles to be hereafter discussed, these facts, without more, entitle plaintiff to judgment.

But beyond that, the manner in which the transaction was handled, the relationship of the parties, and the resulting duties and obligations, not only fortify the plaintiff's claim but furnish an independent ground of recovery.

As we now proceed to show, the taxes were saved through a method conceived, planned and executed by the Operating Company by agents occupying a fiduciary relation to the Corporation, without consideration of any rights of the Corporation and its stockholders and in disregard of their fiduciary obligations.

FINDINGS.

The court below found:

"* * * in 1943, after the filing of the 1942 return and payment of the tax, *the tax attorneys for defendant* 'discovered' Section 123 of the Revenue Act of 1942. (26 USC 23(g) 4). They proposed what they denoted a 'paradoxical' theory, by which the worthlessness of the plaintiff's stock (which had cost the plaintiff some \$75,000,000) in the operating railroad company (debtor), might be availed of as an offset to the operating income of the debtor and thus result in a net loss and no tax obligation." (261, 262)

And again:

"* * * the tax attorneys caused the filing of consolidated tax returns for 1943 and for the forepart of 1944 in the name of plaintiff, in which sufficient portions of the \$75,000,000 stock loss were used as offsets against the operating accounts for these years, so as to show no net income." (262)

"* * * *the tax attorneys for the defendant* conceived a 'paradoxical' plan. *They decided that they would file, * * * consolidated returns on behalf of the parent company and its subsidiaries and in them set up the plaintiff's stock loss * * * as an income tax deduction against the operating profits.*" (265, 266)

And:

"On December 17, 1947, plaintiff filed a supplementary bill of complaint * * * It was there further alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control'." (264)

And:

"* * * there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control'." (272)

The court later, in the course of settling the findings, showed what it meant. It said, "There is no question about it" in response to the assertion that,

"* * * the evidence certainly discloses that the tax operations, however they may be characterized, were conducted *by the defendant and its tax counsel, not by the plaintiff.*" (468)

SUMMARY OF THE FACTS.

Under the law and the Treasury regulations concerning consolidated returns, the returns must be filed in the name of the parent corporation, claims for refund are filed in its name, and all refunds are payable to it.

The defendant used the plaintiff Corporation for its purposes. The facts are fully stated below; in summary, they are these.

The defendant Operating Company employed one Polk and the firm of which he was a partner, Whitman, Ransome, Coulson and Goetz, as its tax attorneys. Polk conceived the plan of using

plaintiff's loss to cancel the defendant's tax liability. He convinced the defendant of the possibility of success of his plan and obtained its authority to proceed.

Plaintiff was in an impoverished condition following the Supreme Court decision of March 15, 1943. It could no longer pay its officers' salaries or office rent. Its officers were taken over as "full time employees" by the defendant on July 1, 1943, before the tax returns were filed, and continued as such until May 1, 1945, when Mr. Curry, the president of plaintiff, moved to Polk's office to be available for these tax matters, ostensibly as an employee of Polk's firm but actually compensated by defendant.

Polk, pursuant to his plan, used these officers to file consolidated tax returns in plaintiff's name, and he caused its loss to be offset against defendant's income. He obtained through Curry a power of attorney from plaintiff. Without the knowledge of plaintiff, but only after specific authorization of defendant, he made an offer of settlement to the Treasury in the name of plaintiff which was finally carried through. He was employed, directed and compensated solely by the defendant, and never gave plaintiff any advice as to its rights.

THE PLAINTIFF'S STUNNED CONDITION.

The plain fact is that the defendant, and Polk and all connected with the transaction, considered plaintiff a defunct and dying corporation and gave no consideration whatever to its rights.

After the Supreme Court decision of March 15, 1943, the plaintiff Corporation was, to select an appropriate metaphor, in a state of coma, stunned by the misfortunes heaped upon it. It had lost its chief asset, its \$75,000,000 investment in the Operating Company. Its other assets were pledged to secure loans then in default (571-573 P 47; also 1767, 1768, 1695-98). Consequently in March 1943, plaintiff's directors were contemplating dissolution and so advised its chief creditors, including the James In

terests (571 P 47). The James Interests would be the controlling interest in the reorganized Operating Company (Corporate Relationship Chart, P 1), and they were represented by Mr. Coulson, Polk's partner (see p. 13. *infra*).

The plaintiff's Delaware franchise taxes were in default, but Polk considered it essential that it remain in existence until the reorganization was consummated (1764 P 5). Funds to pay these taxes were then provided by the James Interests (713).

**PLAINTIFF'S LACK OF INDEPENDENT REPRESENTATION:—
DUALITY AND THE DUALITY CHART.**

The positions occupied during the critical period by those who were directors or officers of the Corporation and the Operating Company are shown by plaintiff's Exhibit 2A. Printing of this exhibit in the record was dispensed with by order of this Court (2175), but we reproduce it at the end of this brief. It will be referred to, from time to time, as the "duality chart."

Prior to June 1, 1943, plaintiff had maintained its offices jointly with those of the Operating Company and the Trustees in New York. Its officers were also employees of the Operating Company, and their salaries and the expenses of the office had been jointly paid.

But plaintiff's impoverished financial condition necessitated a change. As of June 1, 1943, the Corporation was incapable of further paying salaries or office expenses. Thereupon all of the officers and employees of the New York office, including the president and secretary of the plaintiff, were taken over by the defendant by decision of its president, and in his words became its "full time" employees (1738). This situation continued until the Operating Company closed its New York offices on May 1, 1945, when plaintiff Corporation's president and secretary were taken over by defendant's tax counsel and thenceforth received their compensation from them, which compensation was ultimately paid by defendant. (1735, 1738)

From June 1, 1943, until this suit was filed in October 1946, nine persons were at one time or another directors of the plaintiff Corporation. With only three exceptions (Messrs. Osborn, Wood and Hatton), every one of them was an employee of the defendant Operating Company from which they received their livelihood, and one of them (Mr. Schumacher) was not only a director and Chairman of the Company's Executive Committee but was also one of its trustees in bankruptcy.

Of the three who were not employees of the Operating Company and who did not receive any compensation from it, one of them, Mr. Osborn, was a director of the Operating Company and another, Mr. Hatton, was a clerk in the employ of the Denver & Rio Grande Western Railroad and as such recognized Mr. Schumacher as his superior and chief, for Mr. Schumacher was an officer of that company (1135). Three of the nine were mere clerks in the defendant's employ—Miss Sheehan, switchboard operator; Mr. Wienken, stenographer; Miss Valouch, stenographer and clerk. Miss Sheehan and Mr. Hatton were put on the board merely to make up a quorum (1138, 1139), and Miss Valouch did not become a director until the day the New York office was closed, when she became a regular employee of defendant's tax counsel.

Of this whole group of directors, none—other than Mr. Wood and Mr. Osborn—had the capacity, business experience or financial independence of the Operating Company to give competent attention to plaintiff's affairs in any matter wherein the Operating Company could have an adverse interest. Yet, as Mr. Wood and Mr. Osborn testified, not until shortly before the present suit was filed in October 1946, did either ever know or was either advised that the plaintiff's stock loss was being used in tax returns or that thereby defendant was saving taxes; neither knew or was advised of the legal or economic consequences of the filing of the returns involved in this case (Wood, 1129, 1132; Osborn, 1019, 1022).

Meanwhile, plaintiff Corporation had, actually, only one officer, Mr. Curry. Mr. Curry was a competent chief clerk, and he so re-

garded himself (639, 646, 647, 736, 756). When Mr. Schumacher retired as president of the Corporation, in part because of advanced age but primarily because of plaintiff's financial distress (644, 645, 743), there was "nothing facing us but liquidation and dissolution * * * he [Schumacher] felt I [Curry] could carry through", and Mr. Curry was therefore, on February 1, 1942, appointed president and treasurer (743). He was, at the same time, an employee of the defendant Operating Company, its vice president, assistant secretary, assistant treasurer, a director and a member of its executive committee.

After June 1, 1943, although Mr. Curry continued as the plaintiff Corporation's president, he received no compensation from it (645) and thereafter received his livelihood from the defendant Operating Company until May 1, 1945 (1729 P 27) when he went on a pension from the defendant (530, 532) and a retainer from its tax counsel at its ultimate expense (1744 P 32A; 1749 P 42). He did not consider that he had any understanding of, or competence in, tax matters and relied implicitly on tax counsel. "Tax matters were wholly Greek to me," testified Mr. Curry (808).

MESSRS. COULSON AND POLK.

A description of what was done requires an identification of Mr. Coulson and his partner, Mr. Polk, and of the James Interests.

From 1925 until his death in 1941, Mr. Arthur Curtiss James and his wholly owned companies owned 8.8% of the Corporation's preferred stock and 61% of its common stock (Chart, P 1). Mr. Coulson and his firm (Whitman, Ransome, Coulson and Goetz of New York) were attorneys for Mr. James and his companies and were and are attorneys for all the James Interests, including the James Foundation of which he is a trustee (536).

James died in 1941, and after the Supreme Court's decision on March 15, 1943, upholding the Plan of Reorganization, Mr. Coulson and the James Interests decided to cast their lot with the Op-

erating Company, although as a major creditor they could still have voted against the Plan (577, 578).¹²

The common stockholdings of the James group in the Corporation became worthless when the Plan was approved by the Supreme Court. On the other hand, their securities gave them a large interest in the reorganized Operating Company, for they were to receive under the Reorganization Plan 28% of the stock in that Company (Chart, P 1).

MR. COULSON INTRODUCED HIMSELF INTO THE PARTIES' TAX MATTERS, FEBRUARY 1943, AND HIS FIRM BECAME TAX COUNSEL FOR THE DEFENDANT MARCH 1943.

On February 24, 1943, three weeks before the Supreme Court's decision, when his firm was not tax counsel for either plaintiff or defendant, Mr. Coulson introduced himself into their federal tax matters on behalf of the James Interests, by writing Mr. Elsey, president of the Operating Company, asking for information about its tax matters (537 P 37). He was disturbed by the reply, believing Mr. Elsey evasive or not competently looking after taxes. On March 15th, the day of the Supreme Court's decision, he asked his partner, Mr. Polk, by memorandum, to look into the situation, stating (539 P 38):

"Actually, I happen to know that the only person over at the Corporation office here in New York who has any knowledge of taxes is a girl who is primarily Schumacher's Secretary * * * I would be a little surprised if the report were intelligently prepared."

Polk replied that "Only the lady referred to had any part in the preparation of the return * * *. Mr. Curry says they are too impoverished to hire accounting help." (540 P 38A)

Eight days later, on March 23, 1943, Mr. Coulson and his firm became tax counsel for the Trustees and the defendant Operat-

¹²Mr. James' allegiance during his lifetime lay with the Corporation; he sought to save the Corporation's equity in the Operating Company and was active in resisting the Plan of Reorganization of the Interstate Commerce Commission which denied this equity (536).

ing Company, and the actual work was delegated to Mr. Coulson's law partner, Polk, who specialized in tax matters. (543 P 39A-D)

Messrs. Coulson and Polk and their firm obtained all their compensation and received all their instructions from the defendant Operating Company,¹³ but they conducted themselves as attorneys at law and attorneys-in-fact for plaintiff Corporation as well.

In view of the Corporation's misfortune and its stricken condition, it was the high fiduciary duty of its agents to be diligent to protect its rights, to utilize every opportunity that might retrieve something for its stockholders from the debacle, above all not to permit the use of the Corporation's rights, including its stock loss, for the benefit of another, without accounting.

THE PLAINTIFF CORPORATION WAS UNDER NO DUTY TO FILE CONSOLIDATED RETURNS.

Under the law and the regulations, only the parent corporation can file consolidated returns (Reg. 104, Sec. 23.16(a)). The fact that a consolidated return has been filed in one year gives rise to no duty or obligation to file such a return in a subsequent year, if the law or regulations have been so changed as to make it less advantageous (Reg. 104, Sec. 23.11(a)). In that case separate returns may be filed.

Each of the years 1942, 1943 and 1944 was one in which any member of an affiliated group was free to file separate returns, irrespective of whether consolidated returns had been previously filed (II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-7, p. 649, 650). And at the time each return in question here was filed, there existed the right in the plaintiff Corpo-

¹³On November 15, 1948, Coulson rendered a final statement to the defendant "covering professional services in the tax disputes as to the taxable period January 1, 1942 through April 30, 1944" in the amount of \$300,000. At the same time he also rendered a bill to defendant for the retainer payments to Curry, plaintiff's president, for the period July 1, 1945 to December 31, 1948, in the amount of \$10,500 (1749 P 42).

ration not to file a consolidated return if it was so advised. Unless the defendant Operating Company could become a party to consolidated returns with plaintiff, it would have to file or pay taxes on the basis of separate returns. Mr. Polk was aware of these facts (1458).

Prior to the Supreme Court's decision tentative returns on a consolidated basis had been filed for 1942 and an extension obtained until May 15, 1943 for the final returns. Under the regulations, the filing of a tentative consolidated return did not preclude filing the final returns on a separate basis. (Reg. 104, Sec. 23.10(b)). Whether the final return should be a consolidated one was one of the first questions considered by Mr. Polk (543 P 39A). And the severance of the economic unity between plaintiff and defendant which took place between the filing of the tentative returns and the filing of the final returns presented a wholly new consideration.

1942 TAX RETURNS.

Without calling any of these factors to plaintiff's attention, Mr. Polk decided that it was in the interest of the defendant Operating Company that consolidated returns should be filed (Polk, 1444, Coulson, 1482). He had these returns prepared and had them placed before Mr. Curry, vice president of the Operating Company and president of the plaintiff Corporation, for signature. Mr. Curry had been informed by Mr. Schumacher that Mr. Polk was tax counsel for the Operating Company and the Corporation (660). When the returns were laid before him for signature, he therefore inquired whether they had Mr. Polk's approval. Being informed that they had, he signed without consulting or advising the Corporation's board of directors and without being advised by Mr. Polk or anyone else that plaintiff Corporation did not have to file consolidated returns (663, 664).

**THE 1943 RETURNS: THE DECISION TO USE PLAINTIFF'S
STOCK LOSS WAS MADE BY DEFENDANT.**

The idea of using the Corporation's stock loss occurred to Mr. Polk in May 1943. In a letter to Mr. Curry as vice president of the Operating Company, on May 20, 1943, he stated it to be a mere speculation of a possibility and was "commented on rather than suggested * * * since it is paradoxical" ("paradox letter," 588 P 50). Polk sent no advice of it to the Corporation.

In December 1943, Mr. Polk first decided to make use of the plaintiff's stock loss (Polk, 1448; Coulson, 1484). When he came to that conclusion, he did not advise plaintiff or Mr. Curry. Instead, he went to San Francisco to discuss the tax matters with defendant Operating Company's officers, the agents of the reorganization trustees, and in January 1944 he recommended to them the filing of consolidated returns and the use of plaintiff's loss (1448, 1484), although he refused to advise that the defendant Operating Company could "bank" on the Treasury's allowing the deduction.¹⁴ Without advising or consulting plaintiff, he told Mr. Elsey, defendant's president, that "We [the Company] were within our legal rights in taking the Corporation's stock loss as a deduction in our consolidated return" (Elsey, 1268).

The decision to use the plaintiff's loss was made in San Francisco by Mr. Elsey, president of the defendant Operating Company, in January 1944 (1448, 1484). Mr. Elsey insisted on a written opinion to protect him (1268), and such an opinion, dated January 11, 1944, signed by Mr. Coulson, was addressed to him as president of the Operating Company. Although plaintiff Corporation was not consulted, the opinion stated flatly,

"Accordingly, there will be allowed in the consolidated return a loss to the parent company of approximately the cost

¹⁴Mr. Elsey, president of the Operating Company, testified that (1268) "Mr. Polk advised me that we were within our legal right in taking the Corporation's stock loss as a deduction in our consolidated return. * * * I was very much surprised at that statement, and asked him if I could bank on it. He said no, that that matter will not be finally decided until the Treasury Department completes their audit on our '43 returns." Note that in this conversation the plaintiff's loss is treated as though it belonged to the defendant.

of the Railroad Company stock. This loss however computed would appear to far exceed the incomes of the other members of the affiliated group. Accordingly, for the year 1943 on a consolidated return basis there would appear to be no excess profit tax or income tax liability." (605 at 609, 610 P 54).

Mr. Elsey sent a copy of this letter to Mr. Schumacher as one of the defendant's Trustees (613, 614). But no one sent a copy to the plaintiff Corporation or advised it (665). In the Operating Company's annual report for 1943, issued under date of May 1, 1944, 2½ months before the returns for 1943 were filed, it inserted a statement that "A consolidated tax return for 1943 can and will be filed by the holding company" (512). This determination that the plaintiff "will" file a consolidated return was not made by the plaintiff but by the defendant and without consultation with the plaintiff. The decision was made in Mr. Elsey's office (1277, 1278, 1450).

In due course the 1943 returns were prepared under Mr. Polk's direction and were laid before Mr. Curry for signature as president of the Corporation. Mr. Curry had had no part in their preparation, but, being assured that Mr. Polk approved them, he signed, again without consulting the Corporation's board of directors and without being advised that the Corporation need not file a consolidated return if it did not wish to do so (663-665).

1942 REFUND CLAIM BASED ON CARRY-BACK OF PLAINTIFF'S LOSS.

In March 1945, the claim for refund of 1942 taxes based on the carryback of the Corporation's loss was prepared by Mr. Polk on his own initiative and without discussing it with any representative of the Corporation. Mr. Polk sent it to Mr. Curry with the request that he sign it as president of the Corporation (1418, 1450, 1451), and Mr. Curry, being told that Mr. Polk wanted him to sign, did so, again without consulting the Corporation's board of directors (667).

1944 TAX RETURNS:—MR. CURRY IN MR. COULSON'S OFFICE.

Late in 1944, Mr. Polk decided to recommend consolidated returns for the first four months of 1944 (the technical affiliation ended April 30, 1944), again using the plaintiff's loss (1486), and advised the defendant (623). But plaintiff was not advised about this decision. Mr. Polk testified that the decision to file such consolidated returns was made by the defendant Operating Company (1450).

These returns were not filed until June 1945. By that time Mr. Curry was occupying office space with Mr. Coulson's firm. On May 1, 1945, the New York offices of the Operating Company had been closed and all employees let out. On April 21, 1945, in anticipation of that event, Mr. Coulson wrote the president of the defendant to obtain approval of Coulson's retaining Mr. Curry at \$3000 per year; he wished to hire the president of the plaintiff for the purpose of serving the defendant Operating Company's interests in the tax matters here involved (1496). He wrote,

"As president of the old holding Company, which is a party in interest (without financial stake) in the consolidated return period, it seems to us essential that we have Mr. Curry available to secure us necessary data from the files of the holding company [i.e., plaintiff Corporation]" (1743 P 32).

Mr. Coulson did not advise the plaintiff Corporation that it had no financial stake in the consolidated returns, nor did he advise plaintiff of his purpose in taking Mr. Curry on this retainer. Mr. Curry's retainer was approved by the defendant.

On June 1, 1945, Mr. Curry, together with the Corporation's files, moved to Mr. Coulson's office. There he remained until September 10, 1948, when, after the statute of limitations had run against any tax deficiency claim (see p. 23, *infra*), Mr. Coulson requested him to vacate (656). For 3½ years while in Mr. Coulson's office, Mr. Curry received \$3000 per year from Mr. Coulson's firm, for which it eventually billed the defendant Operating Company (1749 P 42). The only services which Mr.

Curry performed for his retainer was to sign the 1944 tax return and execute as president of the Corporation a power of attorney in its name in favor of Polk (657-8).

The return for the first four months of 1944 was filed June 15, 1945. It was prepared in Mr. Polk's office and brought to Mr. Curry, who occupied a room a short distance down the hall from Mr. Polk (1442), to sign (1418). When Mr. Curry first moved to Coulson's office, he was told by Mr. Coulson that "he was to put himself at Mr. Polk's disposal in connection with the consolidated return" (Coulson, 1498). When told that Mr. Polk wanted him to sign in the 1944 return, he signed, again without consultation with his board of directors and without being advised that the Corporation need not file a consolidated return if it did not wish to do so (666).

THE POWER OF ATTORNEY AND THE SETTLEMENT WITH THE GOVERNMENT.

The extent to which the plaintiff was disregarded, and the extent to which the defendant took over the tax affairs of the plaintiff, is illuminated by the manner in which the tax settlement with the government was carried out. All negotiations for settlement with the government were conducted by Mr. Polk in the plaintiff Corporation's name but without its knowledge (Polk, 1451).

On May 31, 1946, Mr. Polk wrote to the Internal Revenue Agent in Charge, justifying the use of the Corporation's loss ("first Krigbaum letter", 1779 P 64), but he never, at any time, advised the Corporation or Mr. Curry of that letter (Polk, 1443; Curry, 667).

Since the government recognizes only the parent corporation in consolidated returns, it then became necessary for Mr. Polk to obtain a power of attorney from the Corporation to continue settlement negotiations. On June 26, 1946, Mr. Polk prepared such a power of attorney running to himself (1784 P 65) and sent it in to Mr. Curry to sign. Mr. Curry signed and he did so

without consulting his board of directors because he was told that Mr. Polk wanted it. (Curry, 668). Thereafter, Mr. Polk "conducted all the negotiations in the name of the plaintiff Corporation under [this] power of attorney" (Polk, 1442, 1451).

On February 11, 1947, Mr. Polk wrote to the Commissioner of Internal Revenue ("Nunan letter" 1662 P 7). This was the offer of settlement that was accepted by the government in August 1947. It was made and signed in plaintiff's name by Mr. Polk; yet he showed no copy to the plaintiff or to Mr. Curry, sent no copy to them, and did not even advise them what was going on until April 1947, although during that period Mr. Curry was occupying a room in the Coulson suite not 50 feet away from Mr. Polk's office (Polk, 1442; Curry, 654), and despite the fact that the present action had been filed by plaintiff against defendant in the previous October.

While ignoring the plaintiff, Messrs. Polk and Coulson were meticulous in obtaining authority from the *defendant* to make the offer of settlement in the name of the *plaintiff*. Mr. Polk, in Washington negotiating with the Treasury, telephoned Mr. Coulson in San Francisco to secure defendant's authority to make the offer. Mr. Coulson and Mr. Elsey, president of the defendant, agreed that this would require authorization by *its* directors (Elsey, 1283, 1284). It was only after the defendant's directors had been polled and approved the offer that Polk delivered the offer in settlement (Coulson, 1494; Polk, 1430). This may be contrasted with Polk's action in writing and delivering the offer in plaintiff's name and under its power of attorney, not only without consulting the plaintiff, but without informing it until two months later.

The reason assigned by Mr. Polk on the witness stand for ignoring the plaintiff in the settlement negotiations was that he supposed "my responsibility was to them [the Company] and not the Corporation" (1431), although the offer was made in the name of the Corporation and not of the Operating Company. However, "I knew of the pending litigation," and finally it

dawned upon him that his conception of his duty was peculiar, and "I came to the conclusion that they should be notified" (1431). Mr. Polk was in San Francisco conferring about this case with the defendant's attorneys when this revelation came upon him; he telephoned to his New York office to send out a letter over his signature to Mr. Curry as president of the Corporation, and this was done on April 2, 1947 (1461, 1787 P 68).

Therein he requested the Corporation's approval of the offer of settlement. Mr. Curry referred it to the plaintiff's board of directors and not until then did the board know that Mr. Curry had signed a power of attorney (1023). The board caused a reply to be sent to Mr. Polk on May 5, 1947 (1794 P 69), wherein it said:

"Although we wish to be entirely cooperative in this matter, the Corporation finds itself embarrassed by the action of the Western Pacific Railroad Company in opposing judicial settlement of the allocations of tax benefits, if any, derived from the application of the capital losses of the Corporation for the benefit of the Group. The Railroad Company's pleadings that the Railroad Corporation should be denied its day in court by reason of the statute of limitations and the District Court's injunctive order in reorganization does not invite the kind of cooperation from the Railroad Corporation that a settlement of the tax case, so ably and fairly proposed by you as counsel for both the Railroad Company and the Railroad Corporation requires. Had there been any question of the Railroad Corporation's right to a determination of the question of allocations of tax benefits, we feel sure that counsel representing both the Railroad Company and the Railroad Corporation would have specifically stipulated, at the time of the filing of the consolidated returns, for such allocation to be determined by the court, if the parties found themselves unable to agree thereto. Inasmuch as in the proposed settlement the Railroad Corporation foregoes its refund claim of \$4,200,000, we think it appropriate that a stipulation promptly be entered into between the Railroad Company and the Railroad Corporation, and the other members of the Group, which will insure the Corporation its day in court for a settlement

of the questions of proper and equitable allocations of tax savings, if any, as well as fixing the amount of the refund as the basis for such savings.

"We trust you will use your good offices, representing both parties in this situation, to secure the approval of the Railroad Company to such a stipulation."

In the meanwhile, on May 6th, Mr. Polk again wrote to the Corporation, requesting approval of the offer of settlement (1797 P 70). But on that very day, without awaiting a reply and knowing that the plaintiff's request of May 5th had not been met, Mr. Polk renewed the offer of settlement, in plaintiff's name, in a conference with Treasury officials, and confirmed that renewal in the so-called "Second Krigbaum letter" of May 19, 1947 (1799 P 71). He signed that letter in the name of the plaintiff, and in it he asserted that "The taxpayer [i.e., plaintiff] on behalf of itself and its affiliated subsidiaries agrees to settle and determine the tax liabilities of said Corporation for the taxable years 1942, 1943 and 1944 in the amounts shown on the returns as filed," although the plaintiff had not yet given him the authority requested in his letter of May 6th. Mr. Polk never informed plaintiff of this "Second Krigbaum letter" (Polk, 1443), and Curry never heard of it until the trial (681).

Polk's offer of settlement to the Treasury was that the tax returns be accepted as filed, the 1943 and 1944 returns showing no tax, and the claim for refund of the 1942 tax be rejected (171). This offer was accepted by the Treasury on August 13, 1947, (174) and the claim for refund was formally rejected on August 6, 1947 (175).

This settlement could have been repudiated by either party (*Botany Worsted Mills v. United States*, 278 U.S. 282), but was not, and the tax saving became certain and final for the first time on June 30, 1948, when the statute of limitations ran against any efficiency assessment (1751 P 42).

COULSON AND POLK NEVER ADVISED PLAINTIFF OF ITS RIGHTS.

At no time did Mr. Coulson or Mr. Polk give any advice to any officer of plaintiff Corporation as to what its rights might be against any other member of the group arising out of the filing of consolidated returns or the use of the plaintiff's stock loss, or advise the plaintiff that it was free not to file consolidated returns, although they knew that to be true (Polk, 1451-1458).

PLAINTIFF LEARNS OF THE USE OF ITS STOCK LOSS AND FILES THIS SUIT IN 1946.

In June 1946, a stockholder's bill was filed in New York by certain of the plaintiff's stockholders. By reason of that suit plaintiff's board of directors first learned of the use of plaintiff's stock loss in consolidated returns to the advantage of the defendant Operating Company (1024). This suit was filed in October 1946.

STIPULATION OF AUGUST 1947, PRETRIAL ORDER, AND SUPPLEMENTAL COMPLAINT.

Settlement with the government had not yet been effected when this suit was commenced.

The plaintiff was concerned that the form of the settlement should not prejudice its rights. Under the law and regulations, any refund under the claim of refund for 1942 taxes would be paid to plaintiff (Reg. 104, Sec. 23.16(a)). But the form of the proposed settlement called for rejection of the claim for refund and would thus leave defendant in possession of all the tax savings (see p. 23, *supra*).

Plaintiff therefore negotiated with the defendant for a stipulation to protect it. Before it was executed, the interveners in this case became fearful that it did not adequately protect the plaintiff's rights, and they applied to the court below for relief. After proceedings in open court (335-399), the court made a pretrial order on the subject (163). That order construed the stipulation and, so construed, made it binding for all purposes of the case.

Upon the basis of that pretrial order, the parties executed and filed the stipulation herein on September 3, 1947 (168-176).

The effect of the pretrial order was to distribute the tax saving of \$17,000,000 over the three-year period, attributing \$3,385,290 to 1942. In short, the claim for refund was not to be deemed to have been abandoned but to be diminished in proportion to the diminution of the entire tax savings, and placed in the same status as if it had actually been refunded and paid by the government to the plaintiff Corporation and by it paid into court to await judgment.

In December 1947, plaintiff filed its supplemental complaint. (208, 231).

III. Other Relevant Facts

TRANSMUTATION OF THE DEFENDANT OPERATING COMPANY.

The defendant is the same legal entity in which the Corporation made its original investment of \$75,000,000, but it has entirely different owners. When it went into bankruptcy in 1935 as the debtor, its properties passed into the control of bankruptcy trustees (1916). But the actual railroad operations continued without interruption in the name and under the direction of the defendant Operating Company's officers.¹⁵

The Reorganization Plan provided that it could be carried out either by revesting the properties (then under the control of the trustees) in the Operating Company, or transferring the properties to a new corporation formed for the purpose (233 I.C.C. 53). Mr. Coulson, a member of the Reorganization Committee, thought the benefits of using the old Operating Company's corporate shell were so substantial that he sought a contractual transfer to the Reorganization Committee by the Corporation of its stock in the Operating Company (621). Otherwise, a new company would have had to be formed in order to wipe out the stock held by the Corporation, as directed by the Plan.

Accordingly, the Reorganization Committee negotiated a contract dated November 22, 1943, with the Corporation and cer-

¹⁵The court order provided that the "business shall be conducted in the name of the debtor by its regularly elected or appointed corporate officers, agents and employees, but under and subject to the direction of said trustees" (1921).

tain of its creditors, whereby the Corporation agreed to transfer the shares to the Committee or its nominee. On December 17, 1943, the Bankruptcy Court approved the "use of the debtor company" in carrying out the Plan (1930), and on April 30, 1944, the stock was transferred by the Corporation to the Reorganization Committee (Chart, P 1).

Thus the affiliation for income tax purposes between the Corporation and the Operating Company did not cease until April 30, 1944. The affiliation continued until then because ownership by plaintiff of defendant's stock continued until that date. But the economic unity, or community of economic interest, had ceased for all time in 1943 (see pp. 6, 7, *supra*), because the right to share economically in defendant by virtue of proprietorship had ceased in 1943; the technical ownership of the stock had become worthless.

CONSUMMATION OF THE REORGANIZATION.

Following the confirmation of the Reorganization Plan in October 1943, the steps necessary to consummate the reorganization were taken in due course. In November 1944 the Bankruptcy Court made its revesting order (36). Pursuant to that order and on December 29, 1944, the operating properties were turned back to the Operating Company by Trustees' Deed, and, under date of December 14, 1944, the Operating Company executed an Assumption Agreement assuming, among other liabilities, "all outstanding current liabilities and obligations incurred by said Trustees * * * arising out of the possession, use, or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business * * *" (1711, 1713).

It will be seen that the tax returns for 1943 and 1944 and the claim of refund for 1942 taxes were all filed *after* the economic unity of the group had ceased and also after technical affiliation had ended. It will be seen further that the filing of the claim for refund of 1942 taxes and the 1944 returns also occurred after the Operating Company was out of the hands of the Trustees. (See Chronology, appearing on the flyleaf of this brief.) The defence

ant Operating Company is the party which joined in all these income tax returns, both during and after bankruptcy. During bankruptcy, although it was in the hands of the Trustees, it joined in the returns in its own name by virtue of Section 52 of the Internal Revenue Code.

THE \$10,100,000 RESERVE FUND TO PAY THE TAXES.

Throughout 1943 the Operating Company made accruals to meet the expected 1943 tax liability in excess of \$7,000,000, and for the first four months of 1944 it made accruals in an amount exceeding \$3,000,000 (614 P 56, 1818-1824, P 76).

When Polk decided in December 1943 that the Corporation's loss could and should be used in the 1943 returns, he recommended that the accruals on the Operating Company's books for 1943 taxes be reversed, but that, because of uncertainties as to the allowance of the Corporation's loss as an offset to Operating Company income, these funds be placed in a special reserve until the taxes were finally determined (602). This was done by order of the Bankruptcy Court on March 3, 1944, when \$7,100,000 was ordered designated "Reserve Fund for Contingent Tax Liabilities" and invested in U. S. Treasury securities to be used to pay any federal taxes found to be due for 1943 (616).

In March 1945, three months after it was out of the hands of the Trustees, the Operating Company established a further reserve of \$3,000,000 against federal taxes, which was also invested in government securities (616).

These reserves, aggregating \$10,100,000, were still intact in the hands of the Operating Company at the time of the trial. They were built up out of earnings during the very years for which the Corporation's loss was used to discharge the Operating Company's taxes.

Since the tax settlement with the government, these reserves have been carried by the defendant as a contingent reserve to meet any judgment in the present action (517, 518).

THE OPERATING COMPANY AFTER REORGANIZATION.

Although the Operating Company is the same legal entity throughout, before, during, and after bankruptcy, it is now a complete financial stranger to the Corporation and has been since March 15, 1943, albeit "paradoxically" affiliated for income tax purposes until April 30, 1944.

When it emerged from reorganization on December 29, 1944, the Operating Company had entirely new owners. The Corporation's investment of \$75,000,000 had been wiped out and a creditor's claim of \$7,750,000 as well. No other interest was wiped out except that of a subsidiary of plaintiff, amounting to \$61,667. Other interests were given income or equity securities in place of fixed debt, or scaled down, but these securities were greatly enhanced in value by the operations during bankruptcy when \$30,000,000 of revenue was devoted to additions and betterments and \$6,000,000 to rolling stock (1944 Annual Report P 20C, page 9; reprinting in the record of the annual reports was dispensed with by this court (2175)).

From the effective date of the Reorganization Plan until the re vesting in December 1944, the Operating Company's net income was sufficient to meet all bond interest and sinking funds required by the Plan, and leave \$20,658,938 applicable to other corporate purposes (1196). In 1943, net income was sufficient, after a deduction for taxes of \$7,100,000 (never paid because of the use of the Corporation's loss) to pay all interest and preferred stock dividend requirements and still leave \$8,929,844 available for common dividends (1195).

When it emerged from bankruptcy January 1, 1945, the Operating Company had an unappropriated earned surplus of \$30,000,000 (1945 Annual Rep. P 20D, page 15).

SPECIFICATION OF ERRORS RELIED UPON

Appellants' statement of points on which they intend to rely on this appeal are set forth at page 2168 of the record. They are fourteen in number but may be summarized as follows:

1. The court erred in failing to hold that the plaintiff Corporation is entitled to an accounting from the Operating Company for the benefits which it obtained as a result of satisfying its tax liabilities by using tax credits and deductions belonging to the Corporation at a time when the Corporation had no financial interest or ownership in the defendant Operating Company.
2. The court erred in holding that what the plaintiff seeks is something in the nature of equity or value for its former ownership of stock in the defendant, or something denied it under the Reorganization Plan.
3. The court erred in holding that the allowance of the deduction of plaintiff's loss from defendant's income for tax purposes was improper, and that such asserted impropriety precluded recovery by plaintiff in this action.
4. It further erred in giving no effect to the stipulation that \$3,385,290 of 1942 taxes must be deemed to have been refunded to the plaintiff and by it paid into court.

THE LEGAL QUESTION PRESENTED AND THE TRIAL COURT'S DECISION

The question here is whether the defendant must account to the plaintiff for the benefits which the defendant obtained by satisfying its federal tax liabilities by using tax rights belonging to the plaintiff, at a time when the plaintiff had lost its stock equity in the defendant, and where the tax rights arose out of that very loss.

It is submitted that under the facts the defendant must account for the following reason:

The defendant has been enriched as a result of using plaintiff's rights. That enrichment is unjust because under the tax law the parent corporation whose rights make tax savings possible (the plaintiff here) is entitled to the benefits arising from the use of those rights in consolidated returns. That enrichment is also unjust because defendant occupied a fiduciary relation to plaintiff and may not retain a benefit received as such fiduciary through

the use of plaintiff's rights. There being an unjust enrichment, defendant must make restitution.

The trial court found the facts in favor of plaintiff. But it rendered judgment for defendant. Then, on timely motion, it amended the judgment to provide that defendant should not recover its costs (325) because "under all of the circumstances of this litigation, it would be more just if each side were to bear its own costs" (323).

The basis of the court's decision was its belief that it was "puzzling, if not downright amazing" that the Operating Company could avail itself of the Corporation's loss (267); that the tax "escape" of the Operating Company was "erroneous and unjust" (271); and that if the court "had the power, I would not hesitate to set aside the tax settlement * * * and order these taxes paid to the United States" (270).

The court was further of the view that the Corporation was not really seeking to share in the tax savings, but that its suit was "rather * * * a circuitous way of obtaining something in the nature of equity or value for its ownership, rejected in the reorganization plan" (272), and that "to make any award, in this cause, under the assumed authority of equity principles, would be in effect to modify the administrative and judicial judgment in the reorganization proceeding" (274).

It concluded that "as between the parties, no persuasion of conscience or equity impels me to do otherwise than to leave the parties where they are, the defendant with the amazing and undeserved tax success; the plaintiff, as the reorganization decree left it, without interest in the debtor" (276).

At pages 76-95, *infra*, we shall discuss the trial court's reasoning and show that it is not sound.

SUMMARY OF THE ARGUMENT

Although the court below referred to the income tax picture presented by this action as "bizarre" (265) and the defendant's use of the tax statute as "puzzling, if not downright amazing" (267), the record reveals that, while the facts are unusual, the

are not in dispute, and the legal principles involved are simple and their application clear.

If the subject matter of this suit were a white horse belonging to the plaintiff, which the defendant appropriated to its own use, it would not take a court long to hold that the defendant was accountable to the plaintiff. That the subject matter is a \$75,000,000 loss sustained by the plaintiff, which the defendant used to discharge its \$17,000,000 tax liability, may present a novel factual situation, but it does not involve unusual legal principles.

The amount is indeed large, but this does not affect the merits. Any shock which the defendant might suffer through having to account for its enrichment is cushioned by the fact that it possesses a funded reserve, consisting of \$10,100,000 of government bonds, for the specific purpose of responding to any judgment rendered against it in this action. This reserve was built up out of charges to current earnings during the years in question for the purpose of paying the very taxes which were later discharged by the use of plaintiff's loss. It would have long since been paid to the United States and spent for war purposes, like the taxes paid by other railroads, had the defendant not used the plaintiff's loss to satisfy its taxes.

Both the controlling facts and the legal principles involved are simple.

The controlling facts, in summary, are these:

1. Plaintiff sustained a loss of \$75,000,000.
2. This loss was of value to anyone who could use it for the purpose of reducing or eliminating income tax. To that extent it was a thing of value, and it was plaintiff's.
3. It could not be used except by plaintiff or with its consent evidenced by a consolidated return in which it joined.
4. Defendant appropriated that loss and right of use to its own benefit to the extent of \$17,000,000.
5. It was able to do this because it occupied a fiduciary relation to plaintiff and a position of dominance and because of equality of positions occupied by officers and employees.

6. By reason of the fiduciary relation and duality of representation, plaintiff was incapable of precluding itself from recovering compensation for this appropriation, by any agreement it might make, or of protecting itself by an agreement, and in fact, because of that fiduciary relation and duality, it made no agreement on the subject.

7. Plaintiff had been a parent and defendant a subsidiary. Defendant's appropriation of plaintiff's loss occurred after plaintiff and defendant had become economic strangers to each other.

The legal principles under which plaintiff's right of recovery flows from these facts may be summarized thus:

A person who is unjustly enriched through use of what belongs to another is required to make restitution to the other. A person is enriched if he has received a benefit. Saving another from expense or loss confers a benefit just as much as the actual delivery of property. A person is unjustly enriched if the retention of the benefit would be unjust.

The purpose of the tax statute in permitting consolidated returns is to allow the group to be regarded as an entity, balancing losses against gains, and thereby necessarily to ameliorate the losses of the parent by the amount of the tax saving. It is not the purpose to permit the subsidiary to escape its just taxes.

When a parent's loss is used in consolidated returns to discharge a subsidiary's tax liability, at a time when the parent-subsidary relationship has been severed and the parent has no further interest in the subsidiary, the subsidiary should account to the parent for the benefit arising from the use of the parent's loss. Retention would be unjust.

Moreover, one who occupies a fiduciary relation to another, as the Operating Company did to the Corporation, may not use that relationship, or the opportunities it affords, or the rights of the other, to obtain a personal benefit, and if he does, he must account for that benefit.

With respect to the reasons expressed in the opinion of the court below, this may be said, in summary:

The use of plaintiff's loss as a tax deduction was proper. Apart from that, the propriety of the tax savings as respects the Treasury was simply not an issue in this action. Moreover, as between the parties it would be no answer to the duty of defendant to account to plaintiff even were there some impropriety in the tax deductions as respects the Treasury, a fact which is nowhere shown in the record and which is unfounded in law.

Under the law consolidated returns could be filed and the Operating Company's tax liability discharged by the Corporation's loss. This was done, and the Treasury Department, after a formal hearing, agreed in writing to this result. The court's comments as to what it would do with the tax settlement if it had the power (i.e., set it aside and order the taxes paid to the government) are entirely gratuitous. They are understandable, however, on the basis that it would be unconscionable for the Operating Company to escape the payment of its just wartime taxes merely because its former parent had lost its \$75,000,000 investment, without any accounting to the former parent for the benefit thus received.

The defendant Operating Company conceived, planned, directed and carried through the tax arrangement. It used the Corporation's loss to discharge \$17,000,000 of its taxes. The tax savings sanctioned by the tax law and agreed to by the Treasury Department should go to the plaintiff Corporation to ameliorate its loss. Any judicial resentment flowing from the astonishment provoked by the unusual tax result should not be directed against the Corporation, whose crushing loss was the basis accepted by the government for cancelling the Operating Company's taxes. Rather, it should be directed to seeing that the benefit intended by the tax statute should accrue to party for whose relief the statute was conceived.

Similarly, the trial court's view that the plaintiff is seeking to obtain something in the nature of equity or value for its former ownership, rejected in the Reorganization Plan, is erroneous. The Reorganization Plan was drastic and wiped out the entire

equity of the stockholder although the railroad was earning a large income. But plaintiff does not seek to go behind the Plan and its drastic treatment. The consummation of the Plan stripped the plaintiff of its ownership but left plaintiff with something in its place—a large loss. The defendant then went beyond the Plan and appropriated what plaintiff had left in order to fatten its surplus by an additional \$17,000,000, something never contemplated by the Plan. The tax savings which gave rise to plaintiff's claim—as a creditor of defendant and not as a former stockholder—arose after the Plan was effected and consummated.

Argument

I.

PLAINTIFF IS ENTITLED TO RECOVER UNDER THE EQUITABLE PRINCIPLES OF UNJUST ENRICHMENT

Fundamentally, plaintiff is entitled to recover on the equitable principle of unjust enrichment. The law of quasi-contract is based on that principle, and it is in the law of quasi-contract that law and equity continue to maintain that capacity to do justice in new situations for which the Anglo-American system of jurisprudence is deservedly famous.¹

¹Williston on Contracts (Rev. ed.), p. 9, states:

" * * * quasi-contractual obligations are imposed by the law for the purpose of bringing about justice without reference to the intention of the parties * * *"

and

"As the law may impose any obligations that justice requires, the only limit in the last analysis to the category of quasi contracts is that the obligation in question more closely resembles those created by contract than those created by tort."

And cf. Sloss, J., in *Humboldt Sav. Bank v. McCleverty*, 161 Cal. 285, 292: "It has always been the pride of courts of equity that they will so mould and adjust their decrees as to award substantial justice according to the requirements of the varying complications that may be presented to them for adjudication." And cf. *Addison v. Holly Hill Co.*, 322 U.S. 607 at 620.

The applicable principle is set forth in the *Restatement of Restitution*, Section 1:

"A person who has been unjustly enriched at the expense of another is required to make restitution to the other."

The meaning of this rule is amplified by the Comment that follows:

"a. A person is enriched if he has received a benefit (see Comment b). A person is unjustly enriched if the retention of the benefit would be unjust (see Comment c). A person obtains restitution when he is restored to the position he formerly occupied either by the return of something which he formerly had or by the receipt of its equivalent in money. Ordinarily, the measure of restitution is the amount of enrichment received (see Comment d), but as stated in Comment e, if the loss suffered differs from the amount of benefit received, the measure of restitution may be more or less than the loss suffered or more or less than the enrichment."

Comment b states:

"What constitutes a benefit. A person confers a benefit upon another if he * * * in any way adds to the other's security or advantage. *He confers a benefit not only where he adds to the property of another, but also where he saves the other from expense or loss. The word 'benefit,' therefore, denotes any form of advantage. The advantage for which a person ordinarily must pay is pecuniary advantage.*
* * *"

It is self-evident that in the present case defendant has been enriched. Here the discharge of defendant's tax liability, by the use of plaintiff's loss and credits, was the conferring of a benefit upon the defendant and its enrichment, within the meaning of the law of quasi-contract, just as much as if the defendant had taken dollars from the plaintiff and with those dollars discharged his tax liability.

The Shreveport Bank Cases.

The duty to make restitution applies just as much where the enrichment consists of tax savings as where it consists of some other kind of benefit. In *Commercial Nat. Bank in Shreveport v. Connolly*, 176 F.2d 1004 (5 Cir.) decided September 6, 1949, the very day that the court below rendered its opinion in this case, one corporation was ordered to account to another for tax savings resulting from the use of the latter's tax credits. Numerous other issues were involved in the suit, but on the issue that is relevant here the facts are as follows:

The Commercial National Bank of Shreveport [the old bank], being in financial straits, transferred its assets to a new bank, Commercial National Bank in Shreveport [the new bank], and the latter assumed its liabilities. Later a receiver for the old bank was appointed. Still later the receiver sued the new bank for an accounting.

The State of Louisiana, in which the banks were located, imposes a tax on the capital stock of national banks, assessable against the bank. In determining the assessable value of the stock, the Louisiana law provides that the assessed value of real estate owned by the bank is deductible from what would otherwise be the value of the stock.

Over a space of 5 years the new bank, in determining the tax value of its capital stock, treated the real estate of the old bank, which had been transferred to the new bank and stood in its name, as its own property. Thereby, over a period of 5 years it paid in taxes \$192,000 less than it otherwise would have. In short, it saved taxes of \$192,000.

In *Leslie v. Commercial Nat. Bank In Shreveport*, 28 F. Supp. 927, the District Court found that the property had been transferred by the old bank to the new in pledge and therefore still belonged to the old bank. On this factual basis it held that the new bank must account to the old bank for this tax savings, even though the old bank had suffered no detriment. Its reasoning was as follows (p. 933):

"* * * There can be little question but what the relation of the new Bank to the old and the administration of the property and estate intrusted to the former, was one requiring the utmost good faith and constituted it an agent, trustee or fiduciary. * * * It could not profit therefrom in any manner other than as provided by the contract, or permit anyone else to do so. * * *

"* * * The fact that the new Bank and its officers would be placed in a dual relationship with respect to the old and new Banks and their respective stockholders, was necessarily known to both sides, as parties to the contract, because of its very nature. * * * I do not believe that the property of the Old Bank could be thus used without its consent to the benefit and profit of the stockholders of the new Bank, and the latter should not be allowed to take credit for the taxes paid under the circumstances of this case.

"* * * The fact that the Old Bank suffered no loss or will be benefited by this conclusion makes no difference. (See the authorities above cited.)"

On appeal the Circuit Court of Appeals for the Fifth Circuit agreed with the District Judge on this phase of the case. *Commercial Nat. Bank in Shreveport v. Parsons*, 144 F.2d 231. The court said on this point:

"It was the appellant's duty as pledgee and liquidator to pay taxes on the trust estate, and the amount so paid was properly charged to the old bank; but appellant had no right to deduct from the assessed value of its own capital stock the value of such real estate as was shown on its published statements, because it was not the owner thereof within the meaning of the statute authorizing such deductions. *The credit thus obtained by the new bank was a profit derived from the trust property as effectively as if it had been paid that much in cash.* This was a profit of \$191,-778.55, which over a series of years was obtained by appellant from the use and possession of, and record title to, trust property. It clearly does not belong to the trustee or to its stockholders. What shall be done with it in an accounting between the trustee and the cestui que trust?

"* * * We concur in the opinion of the court below that the items in controversy should have been credited to the

cestui que trust, and refer to the authorities therein cited.”
(pp. 236, 237)

A petition for rehearing was denied, 145 F.2d 191, as was certiorari, 323 U. S. 796.

On remand the new bank sought leave to deny that the assets had been transferred in pledge and to assert that they had been transferred outright. The trial court adhered to its decision relative to the tax savings. *Connolly v. Commercial Nat. Bank in Shreveport*, 72 F. Supp. 961 at 963.

On a second appeal, the Court of Appeals sat en banc. This time a majority of the court held that most of the assets had been transferred outright to the new bank, and that consequently the tax savings derived therefrom resulted from the new bank's own property.

But as to certain other assets, it was held that they had been transferred in pledge, and that the new bank must account to the old for tax savings resulting from their use. *Commercial Nat. Bank in Shreveport v. Connolly*, 176 F.2d 1004 (Sept. 6, 1949). On the first appeal there had been one dissent as to the duty to account for the tax savings. But on the second appeal the court's opinion was written by the very judge who had dissented on the first appeal. Thus the whole court finally concurred that there was a duty to account for tax savings to the party whose rights were used to achieve that saving. The court said (p. 1008):

“* * * the New Bank should account to the receiver of the Old Bank for all such savings as accrued to it from the inclusion of any Class C real estate in its capital stock tax return.”

The rationale of the dissenting opinion on the first appeal was similar to that of the court below in this case. The fact that the dissenting judge abandoned those views on the second appeal and embraced the other opinion is significant. We shall consider this phase of the case further (pp. 84, 85, below).

A. THE RETENTION OF THE BENEFITS RECEIVED BY DEFENDANT WOULD BE UNJUST FOR TWO MAJOR REASONS. THE FIRST REASON IS THAT SUCH RETENTION IS INCONSISTENT WITH THE RATIONALE AND PURPOSES OF CONSOLIDATED RETURNS.

We have seen that the defendant has been enriched. And we have seen that if the enrichment was unjust, plaintiff is entitled to recover. The enrichment was unjust for two independent reasons, each of which we shall discuss.

The first reason is that such retention is inconsistent with the rationale of consolidated returns and with the purpose of Congress in allowing them.

The principle underlying consolidated returns—their rationale—is summarized in II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-1947 issue, at page 633, where legislative reports and similar material are quoted.² The principle is this: A group of affiliated corporations is an economic entity and, unless the group as a whole in the conduct of the business enterprise shows net profits, those who conduct the business—the owners of the parent—have realized no gain, despite the legal fiction of separate corporations. As said in *Handy & Harman v. Burnet*, 284 U.S. 136, 140, the purpose is

“to require taxes to be levied according to the true net income and invested capital resulting from and employed in a single business enterprise, even though it was conducted by means of more than one corporation.”

The rationale of consolidated returns “is the recognition of this common owner's right to set off against his gains in the one

²Consolidated returns were first required, but only for excess profits tax, by Treasury Regulation in 1917. This was validated by the 1921 Act. Consolidated returns were compulsory for both normal and excess profits taxes between 1918 and 1921, inclusive. They were permissive but not mandatory for 1922-1933, inclusive. They were not permitted, except in case of certain railroad corporations, from 1934-1939, inclusive. They were permissive for all corporations with respect to excess profits taxes in 1940 and 1941. In 1942 the Revenue Act, Section 141(a), extended the privilege to all corporations for all years after December 31, 1941, with respect to both normal taxes and excess profits taxes. (For the foregoing history see II Montgomery's Federal Taxes, Corporations and Partnerships, 1946-1947 issue, at p. 632.) •

[corporation] his losses in the other [corporation]." *Duke Power Co. v. Commissioner of Internal Revenue*, 44 F.2d 543 at 545 (4 Cir.), *cer. den.*, 282 U.S. 903, containing an excellent statement of the history and purpose of consolidated returns and the concept of the economic unity. So also *Alameda Inv. Co. v. McLaughlin*, 28 F.2d 81 (D.C. N.D. Cal.), *aff'd* 33 F.2d 120 (9 Cir).

In Appendix One to this brief we quote from some of the legislative history on the subject.

When the law recognizes the group of affiliated corporations as an economic entity and permits the offsetting of the profits of one affiliate against the losses of another, it does so for the purpose and with the effect of benefiting the ultimate owners of the business entity, who are, of course, the stockholders of the parent corporation. The means which the law adopts to benefit these ultimate owners is the amelioration of the loss suffered by the ultimate owners because of losses of any one affiliate; this amelioration is accomplished by permitting the losses to reduce or eliminate, for tax purposes, the profits of other affiliates.

The present case is an unusual one because the economic unity between the parent and the subsidiary was severed before the tax saving was claimed or achieved, the severance being the very fact that produced the loss.

In such a case, if the tax saving is permitted to be retained by the former subsidiary after severance of the economic unity, without making restitution to the parent, particularly where the loss was that of the parent directly, both of the underlying principles of the consolidated return provisions of the income tax law have been defeated:— (1) The stockholders of the parent corporation will not obtain the benefit resulting from filing a consolidated return, and (2) in addition, the loss which they suffered—and here suffered directly—will not have been ameliorated.

On the contrary, new owners of the former subsidiary will reap a profit—a sheer windfall—from the misfortune of the old owners. The income tax laws will have been used to enrich complete strangers to the economic entity for whose protection consolidated returns are permitted. The fact that the retention of the enrich-

ment would defeat the policy of the statute shows the enrichment to have been unjust.

In *Woolford Realty Co. v. Rose*, 286 U.S. 319, the Supreme Court (Cardozo, J.) held that the use of consolidated returns did not permit a corporation to deduct from its profits the loss of an affiliate sustained in a year prior to that in which the affiliation began. "The mind rebels against the notion," it said, "that Congress in permitting a consolidated return" was willing to permit a corporation to profit by the loss of one who was a stranger when the loss was sustained.

In the present case we have the converse situation, for here the tax savings were claimed after the economic unity was destroyed, and laws and regulations had come into effect subsequent to *Woolford* which permitted the tax saving in this case. But it is just as shocking to one's sense of justice to permit the defendant to appropriate for its *own* benefit losses with which it had nothing to do, as it was in the *Woolford* case to contemplate the appropriation by one affiliate of the losses suffered by another in years prior to the time of affiliation.

If the economic unity had not been severed, the benefits would still inure to plaintiff though retained by defendant. But "the mind rebels against the notion" that, after the economic unity has been terminated, the defendant may appropriate plaintiff's tax credit resulting from plaintiff's losses without making restitution. In the language of the *Woolford* case, "to such an attempt the reaction of an impartial mind is little short of instinctive." This "instinctive reaction" of which the Court speaks is the equivalent of the conscience of the chancellor, the "good conscience" with which the law of quasi-contract and unjust enrichment is concerned, and which determines whether an enrichment is just or unjust. *The party whose loss made the tax saving possible should receive it as a partial amelioration of its loss*, rather than another who was not in good conscience entitled to any tax saving whatever.

In *Helvering v. Morgan's, Inc.*, 293 U.S. 121, 127, the court said that "After affiliation, as before, the affiliated corporations,

although filing consolidated returns, continued to be separate taxable units. The consolidated returns operated only to unite them for the purpose of tax computation and the equitable apportionment between them of the tax thus computed."

Equitable apportionment of the tax involves equitable apportionment of the savings, and *what is equitable must be decided in the light of the fact which distinguishes our present case from all others, namely, that the corporations are in fact separate entities*, not merely legally, as the *Morgan's* case indicates is true of all affiliates filing consolidated returns, but also economically and factually.

The Report of the Senate Finance Committee on the Revenue Bill of 1928, 70th Congress, 1st session, Senate Report 960, which we quote in part in appendix one to this brief, also stated that "Much of the misapprehension about consolidated returns will be removed when it is realized that * * * *no ultimate advantage under the tax laws really results.*" Similarly, in the Report of the Senate Finance Committee on the Revenue Bill of 1932, 72nd Congress, 1st session, Senate Report 665, at page 9, it was said concerning consolidated returns, "No improper benefits are obtained from the privilege."

After quoting these passages, the Board of Tax Appeals in *J. D. & A. B. Spreckels Co.*, 41 B.T.A. 370, 375, answered in the negative the question "whether or not the framers of the statute intended that the privilege of making consolidated returns may be enjoyed in cases where the affiliation does not serve a business purpose, as distinguished from a tax-reducing purpose."

No purpose other than a tax reducing purpose could have been served in the present case *except by applying the tax savings to ameliorate plaintiff's loss*. Otherwise, it cannot conceivably be said that "no ultimate advantage under the tax laws really results" or that "No improper benefits are obtained from the privilege."

The Law and Regulations Concerning Joinder in Consolidated Returns by One in Receivership or Bankruptcy.

Section 52 of the Internal Revenue Code provides that when a trustee in bankruptcy is operating the business of a corporation, he shall make the income tax returns for it in the same manner and form as corporations are required to do, and the tax due on the basis of the returns shall be collected in the same manner as if collected from the corporation.

Treasury Regulation 104, Sec. 23.15, subd. (b), provides that if one or more, but not all, of the members of an affiliated group are in bankruptcy, the tax liability of each such member for the period covered by a consolidated return shall not exceed such portion of the consolidated tax liability as the affiliates may agree upon, or, in the absence of such an agreement, an amount equal to its liability "computed as if a separate return had been filed."

And in the fall of 1942, Section 23(g)(4) was added to the Internal Revenue Code to permit the loss of a parent corporation resulting from worthlessness of stock of a subsidiary to be used as an operating loss. But for this amendment the plaintiff's loss could not have been used to offset defendant's income.

Bankruptcy of a subsidiary usually makes the stock interest of the parent valueless and deprives the parent of control over it. However, under the foregoing provisions, any stock loss of the parent resulting from the bankruptcy is offsettable against the income of the subsidiary, the subsidiary being permitted to pay a tax computed "as if a separate return had been filed," thus giving the tax benefit of the parent's loss to the parent.

The several provisions of the law and regulations thus show a legislative intention that a parent whose subsidiary goes into bankruptcy, with resulting loss of the value of the parent's stock, should have the benefit of any tax saving resulting through the filing of consolidated returns and the offsetting of the subsidiary's income by the parent's loss.

Defendant's tax counsel, Polk, explained the purpose of the 1942 change in the tax law, made by the addition of Section 23(g)(4), as follows (1447):

"Q. As a matter of fact, this case could not have happened except for a change in the law in October 1942, could it?

"A. No, it could not have.

"Q. What was that change in the law which made this possible?

"A. Well, there was a *very unfair situation* in consolidated return accounting up to that point that section 23(g) (4) was designed to correct. You see, under consolidated returns inter-company transactions are eliminated, and where a parent corporation puts out its cash for a subsidiary company and then the subsidiary company becomes worthless, if you eliminate the worthlessness as an intercompany transaction, *there has been, in the usual case, a deprivation of capital, a loss of capital and no reflection for tax purposes, and that was corrected by the insertion into the Internal Revenue Code of Section 23(g) (4).*"

The "unfair situation" of which Polk spoke was that the *parent* had lost capital but derived no tax benefit from it. This "unfair situation" was corrected by the 1942 amendment. To permit the subsidiary to profit, instead of having the tax saving applied to ameliorate the parent's loss, would utterly fail to correct any such unfairness.

S.E.C. Decisions.

In point is a ruling of the Securities and Exchange Commission, entitled "*In the Matter of Consolidated Electric and Gas Company*", 15 S.E.C. Decisions and Reports, 161 (1943). That case arose under the Public Utility Holding Company Act of 1935.³ Section 12 prohibits certain intercorporate transactions between parents and subsidiaries, and the Act requires notice of intended transactions to be filed with the Commission to give it an opportunity to pass upon them. S.E.C. Regulation U-45 prohibits cer-

³Since that Act regulates gas and electric holding companies and does not apply to a railroad corporation, the Act itself is not pertinent, but the problem arising under it and presented to the S. E. C. involved principles applicable here.

tain donations between parents and subsidiaries with exceptions in the case of consolidated tax returns.

In the particular case Consolidated Electric and Gas Company filed a notice with the Commission that it and its various subsidiaries had entered into a contract whereby it was to be primarily responsible for the payment of the taxes resulting from consolidated returns and each of the subsidiaries should pay as its share an amount representing that percentage of the total consolidated taxes of the group which the tax of the particular company, computed on a separate basis, would bear to the total amount of taxes of all the parties, computed on a separate basis.

A consolidated return was to be filed for 1943, and a tax saving of \$2,156,804 would result from the fact that the parent had or would suffer a loss in disposing of its investment in approximately nine subsidiaries. This loss was, for tax purposes, in every respect identical with the loss sustained by the plaintiff here from the worthlessness of its stock in the defendant.

Consolidated Electric desired approval of its determination to alter the agreement so as to permit the remaining subsidiaries to make direct payment to it of amounts equal to those that they would save under the consolidated return by virtue of the capital loss incurred by the parent company.

The Commission approved this proposal, thereby holding that it was equitable that the affiliate securing the benefit of the tax saving resulting from the parent's loss should pay the amount of such saving to the parent which had suffered the loss. The Commission said that

"To the extent that tax savings may accrue to the parent in connection with such sales, the result is in effect to reduce the amount of loss accruing to Consolidated by virtue of the transaction" (p. 163)

and expressed its conclusion as follows:

"Under all the circumstances, we believe that it is more realistic to view the tax savings as, in effect, partial offsets to the capital losses otherwise suffered by Consolidated in connection with the sales." (p. 164)

In the *Consolidated* case the affiliation continued. Consequently, as the Commission remarked, the savings eventually would have inured to the parent anyway by virtue of dividend payments, or, if the parent should dispose of its stockholdings in the subsidiaries, by increasing the value of the stock. The injustice of not having the tax savings transferred immediately to the parent would therefore not have been great. Nevertheless the Commission felt that a direct transfer was appropriate. *A fortiori*, in the present case, where the economic unity has been split so that the tax savings cannot inure to the parent by virtue of dividends, the justice of requiring the defendant to transfer the tax saving to the plaintiff to ameliorate its loss, by virtue of which alone the savings was possible, is apparent.

In another matter before the S. E. C. involving the same parent, *In the Matter of Consolidated Electric and Gas Company*, 13 S.E.C. Decisions and Reports 649 the loss was that of Islands, one of the subsidiaries, instead of the parent as in the case just reviewed. By means of consolidated returns the parent and affiliates other than Islands saved nearly \$1,500,000 in taxes by reason of Island's loss.

The S. E. C. approved an application of the parent to pay to Islands an amount equal to the tax savings of the parent and other affiliates, since (13 S.E.C. at 658)

"The tax savings * * * has its origin in a loss sustained by Islands and it seems eminently equitable that the cash be applied, as proposed, to the satisfaction of the Series A bonds of Islands, the holders of which have legal recourse against Islands alone."

Two principles of equity are apparent from these cases: (1) that the tax saving should go to the ultimate owner of the economic entity—the parent, and (2) that it should go to the party suffering the loss, to ameliorate it. So long as the economic unity continues, these two principles coincide, for no matter which affiliate sustains the loss in the first instance, the parent also sustains it—at once if it is the affiliate, or ultimately if the loss was

that of a subsidiary. Thus, in the *Islands* case the parent allocated the tax benefits, resulting from a loss, in a manner best serving its own interests, for by using the tax savings to pay off the subsidiary's bonded debt the parent increased the value of its own equity.

In the present case, too, both equities coincide, the equity that the tax saving should go to the parent and the equity that it should go to the party sustaining the loss, to ameliorate it. Both equities sustain plaintiff's right to recover. And both demonstrate that it would be inequitable for the tax savings to go to one that was neither the parent nor the sufferer of the loss.

The Trial Court Recognized the Injustice of Defendant's Keeping the Tax Savings and Yet for That Very Reason Denied Plaintiff Recovery.

For defendant to keep the tax saving is, then, a subversion of the tax laws.

The trial court certainly was of that view. It so stated in its opinion in vigorous language. The consequence is that plaintiff should have judgment. To permit plaintiff to receive the benefit of the tax savings is to fulfill the object of the tax laws in permitting consolidated returns, since the only justification for the defendant's not paying its taxes was that the resulting savings would go to ameliorate plaintiff's loss.

Yet—curiously—because the trial court believed the *defendant* had wronged the government, it denied recovery to the plaintiff, thereby rewarding the defendant by permitting it to keep the unconscionable gain.

At pages 76-88, *infra*, we shall discuss at some length this reasoning of the trial court.

Plaintiff's Right to Recover Is Supported by Elementary Equitable Rules of Contribution.

A basic principle of equity and quasi-contract is that of "contribution". Situations often arise where, as respects a third party to whom a duty is owed, two persons are both liable; yet, as between themselves, the burden should be discharged in whole or

in part by one of them only, either because of agreement between them or apart from agreement. If one of the parties discharges the obligation, he is entitled to restitution from the other who should have done so. *Restatement of Restitution*, Section 81, Comment under Section 81, and the sections following, as well as the "Introductory Note" under Topic 3 at pages 327, et seq.

As stated on page 328 of the Restatement, even if the parties do not have in mind the necessity of such restitution, or do not think of it in detail, a duty will be imposed.

These principles apply to tax situations, including those involved in consolidated returns, as much as they do to any other situation.

Bankers Trust Co. v. Florida East Coast Car Ferry Co., 92 F.2d 450 (5 Cir.) illustrates that application. That case involved a consolidated return in which the net income of one of the affiliates, "A", was greatly overstated, resulting in an excess tax chargeable to it of \$195,000, and the income of another affiliate, "B", was greatly understated. The tax deficiency resulting from the understatement amounted to \$99,000. Offsetting the two, there still was a net refund of \$96,000 resulting from the overstatement.

Two questions arose. The first question was to whom the refund of \$96,000 should go. This question presented no problem. The refund went to A, not because A had paid the money but because the refund was due to A's own tax credits; that is, on a separate return basis the \$96,000 would never have had to be paid by A.

The second question was whether A was entitled to recover \$99,000 from B. A had overpaid that amount in addition to the \$96,000 and would have been entitled to its refund from the tax authorities except for the fact that it was applied to pay the additional tax due from B. In short, A's credit paid B's tax, as a result of the consolidated reporting.

It was held that the affiliate whose income had been overstated was entitled to reimbursement in the amount of \$99,000 from the receiver of the affiliate whose income had been understated.

So, in the present case, defendant's tax liability was discharged, not by its paying anything, but by use of a tax credit belonging to the plaintiff Corporation.

The two affiliates involved in the *Florida East Coast* case were subsidiaries of a common parent. The one that had received the benefit of the other's tax credits was in the hands of receivers. Were it not for the intervention of the receivership, it would have been a matter of no practical concern whether or not the affiliate receiving the benefit of the other's credits accounted to that other, because in either event the common parent would be the ultimate economic beneficiary. It would be irrelevant whether the gain reached the parent through its ownership of the one corporation or of the other, and the ultimate disposition of the benefit would lie in the parent's hands. But the insolvency of the first affiliate, resulting in the receivership, meant that the rights of that affiliate's creditors intervened between it and its parent; there was a severance of the economic unity. If the tax benefits were allowed to remain in the hands of the receivers, they would never reach the parent. It thus became important that the incidence of gains and benefits should be placed where they properly belonged. And they were so placed in the *Florida East Coast* case by the judgment rendered.

In the ordinary situation, where there has been no severance of economic unity, questions such as these are not likely to occur. So in our case it was a matter of no moment before 1943 whether the benefit of particular tax savings should flow initially to the plaintiff Corporation or the defendant Operating Company. But once economic severance occurred, the issue became important. Here the severance occurred as the result of adjudication in 1943 that plaintiff was not entitled to an equity in the reorganized defendant. While in the *Florida East Coast* case the severance occurred because of the intervention of the rights of creditors, the principle is the same.

As respects the government, two or more parties may be liable for taxes, but this does not determine the rights of the parties

between themselves, which are governed by principles of general jurisprudence. If the tax liability is justly that of one party, either in whole or in part, and another discharges that tax liability, the latter is entitled to recover from the former, regardless of what the tax law provides about liability to the government. *Phillips Jones Corp. v. Parmley*, 302 U. S. 233; *Wolters v. Henningsan*, 114 Cal. 433. As said by the United States Tax Court in *Koppers Co.*, 8 T. C. 886 at 891,

"The right of contribution is not founded upon contract and arises as a matter of general law whenever one pays on a common obligation in excess of the share proper as between himself and others similarly liable."

In tax cases a right to contribution from other members of an affiliated group may arise from overpayment of one's share. *Koppers Co.*, 11 T. C. 894. Although all members of an affiliated group may be severally liable to the government for the whole tax, "as between themselves, each affiliate [is] mutually obligated under principles of general law to pay only its fair share of the common burden." *Koppers Co.*, 8 T. C. at 891.

In the present case, the plaintiff had no income and its fair share of the tax burden was therefore nothing whatever. Since defendant's tax liability was fully discharged by the use of plaintiff's tax credits, plaintiff has a right to restitution from defendant for the benefit received.

The cases just discussed show that liability for payment of taxes to the Government and the right to receive refunds from the Government are not determinative of the ultimate liability of affiliates among themselves to share the tax burden and distribute tax refunds; hence, where there is no agreement on these matters but one acts for all, a duty of contribution or distribution (as the case may be) arises which it is the province of equity to adjust simply because there is no agreement.

RETENTION OF THE BENEFITS RECEIVED BY DEFENDANT WOULD BE UNJUST BECAUSE PLAINTIFF WAS UNDER NO DUTY TO CONFER ON DEFENDANT THE BENEFIT OF ITS LOSS, AND DEFENDANT, OCCUPYING A FIDUCIARY RELATION TO THE PLAINTIFF, APPROPRIATED THAT LOSS TO ITS OWN USE.

**Plaintiff Was Under No Duty to Join in Consolidated Returns
or to Confer on Defendant the Benefit of Its Tax Credits.**

Under the tax law and regulations plaintiff was free, in each of the years in question, to file a separate return (although its tax counsel, who were counsel for defendant, failed to so advise (see pp. 15, 16, 24, *supra*)).

A parent owes no duty to any subsidiary to join or not to join in a consolidated return. It is free to decide solely on the basis of its own interests whether consolidated returns should be filed. This principle and its rationale are declared in *Duke Power Co. v. Commissioner of Internal Revenue*, 44 F.2d 543, 545 (4 Cir.), where it was held that a subsidiary had no right to the benefits of a consolidated return where the parent chose to file a separate return.

Since this is true when the economic unity exists, patently the parent owes no duty to a former subsidiary to join in consolidated returns for the latter's benefit, after the economic unity has been severed, merely because continuance of technical affiliation makes such returns permissible. In this case the economic unity was severed before the tax returns were filed. In the words of the court *during the trial* (1380), the parties were "free agents to agree with one another to file this type of return"; that is, to agree or to refuse to agree. Yet, oddly, when it decided the case, the court observed in its opinion that "there is some merit to defendant's contention that a firm obligation rested upon plaintiff to inform and cooperate" to give defendant the benefit of its loss (75). The opinion, however, contains no suggestion of any reasons to support this view, which we submit has no substance.⁴

Elsewhere in its opinion the court asserts that the tax savings were "amazing and undeserved." (276) It is impossible to reconcile the two statements. How could plaintiff be under an obligation to give defendant "amazing and undeserved" benefit?

Certain it is that the Bankruptcy Court could not have ordered the plaintiff to join in consolidated returns and to give defendant the benefit of its loss. Not only was defendant already out of bankruptcy when the 1944 return and the claim for refund were filed, but, quite apart from that fact, the Bankruptcy Court would have been without jurisdiction to make any such order. *Callaway v. Benton*, 336 U. S. 132, and *Benton v. Callaway*, 165 F.2d 87, which it affirmed, are conclusive on that point.⁵

Thus the suggestion that, somehow, the plaintiff might have been under an obligation to join in consolidated returns with defendant for the latter's benefit can only mean, if it means anything, that the defendant by an independent suit in equity against plaintiff could have compelled it to join in such a return gratuitously.

The basis of any such suit defies understanding. If the plaintiff had earned \$75,000,000 in other enterprises in 1942, 1943 and 1944, its \$75,000,000 stock loss would have eliminated its tax on that income, and no one would even think of suggesting that it could have been compelled, instead, to give the benefit of its loss to defendant. Indeed, defendant conceded in its trial brief (at p. 40) that "if during the critical years plaintiff had * * * taxable income * * * plaintiff would have a different case." The argument apparently is that unless plaintiff could have used its loss to its own advantage, it could have been compelled to give

⁵Under Section 77 (the railroad reorganization section) a bankruptcy court's *in personam* jurisdiction is confined to the debtor. Here that was defendant, for it was the defendant and not the plaintiff that was in reorganization. The court's *in rem* jurisdiction is confined to property in the debtor's possession. It has no jurisdiction over disputes with others involving property in the debtor's possession. *Bankruptcy Act*, Sec. 77 (Title 11 U.S.C., Sec. 205(a)); 5 *Collier on Bankruptcy* (14th ed.) 49; *Thompson v. Terminal Shares*, 104 F.2d 1 (8 Cir.), *cert. den.* 308 U.S. 559, approved in *Callaway v. Benton*, *supra*.

In *Callaway v. Benton*, it was held that a bankruptcy court had no jurisdiction to compel another to transfer rights to the trustees or to enter into a contract with them. Any attempt of the Bankruptcy Court to compel the plaintiff here to join in a consolidated return would have been merely an effort to exercise jurisdiction *in personam* over the plaintiff.

it away. We shall show at pp. 66-74, *infra*, that there is no validity to any such contention.

There was no duty, legal or moral, on plaintiff gratuitously to confer the benefit of its loss on defendant.

Had defendant openly approached and fully disclosed the situation to the plaintiff, the latter could have obtained independent officers and counsel, and the parties could then have arrived at whatever agreement on the subject seemed equitable to them, determining how the benefit of the tax saving should be apportioned. Such an agreement would have been an easy and simple way to settle the question.

But this was not done. No such agreement was made, *simply and bluntly because the defendant took over and managed the entire tax matter in a setting of duality of officers and agents.*

The court below in its opinion says (274): "In the final analysis, plaintiff's hope to succeed here depends upon whether it could have lawfully acquired these unpaid tax moneys by voluntary agreement between the directorates of the two companies. In my opinion, it could not." The reason then assigned for this conclusion is that such agreement would "nullify the Reorganization Plan". At pages 88-95, *infra*, we show there is no merit in that reasoning.

As we shall point out at page 75, *infra*, plaintiff's rights do not depend on whether an agreement could have been made prior to the realization of the tax savings. Nevertheless, an agreement between parties to a consolidated return concerning allocation of taxes or advantages is perfectly proper and not unusual. The propriety of such an agreement has always been recognized by the income tax law and regulations. Former revenue acts provided that the taxes under a consolidated return were to be assessed to the respective corporations in such proportions as they might agree upon and prescribed no other basis unless the parties failed to agree.⁶ Under the present law the matter is

⁶Act of 1921, Sec. 240(b), 42 Stat. 260; Act of 1924, Sec. 240(b), 43 Stat. 288; Act of 1926, Sec. 240(b), 44 Stat. 825.

left to Treasury regulations (Internal Revenue Code, Sec. 141 Subd. b). These recognize such agreements so long as they do not lessen the liability of any affiliate to the Treasury, the whole tax being assessable against any one of the corporations joining in the return (Reg. 104, Sec. 23.15(a)). Indeed, Sec. 23.15(d) recognizes an agreement even though it limits liability of any one corporation to the Treasury, if that affiliate is in bankruptcy.

The propriety of voluntary agreements between parties is further shown by the two cases before the Securities and Exchange Commission involving the *Consolidated Electric* system, which we discuss at pages 44-47, *supra*. It is further shown by *Truncal v. Universal Pictures Co.*, 76 F. Supp. 465, which we discuss at pages 71, 72, *infra*.

And it is also shown by an order entered on July 29, 1947, in the United States District Court for the Eastern District of Missouri in railroad reorganization proceedings entitled "*In the Matter of Missouri Pacific Railroad Company, Debtor*," No. 693 (unreported). There a parent railroad owned all the stock and bonds of a group of affiliated railroads, known as the "Gulf Coast Lines." It also owned all the stock of another company, the International. All of these companies were debtors in the same bankruptcy proceedings and were operated by the same trustee. Separate tax returns for 1946 would result in no tax for the International but in a liability of over \$2,500,000 for the Gulf Lines, but under a consolidated return International's loss would reduce the tax liability of the others by over \$2,000,000.

Since all the parties were operated by the same trustee, an agreement by him in his capacity of trustee for one of the groups with himself as trustee for the others required approval of the court (because of duality). For that reason he applied to the court to approve an arrangement whereby a consolidated return would be filed and the Gulf Lines would pay to International about \$1,860,000 of their resulting tax savings in consideration of International's joining with them in the return. The court approved the arrangement.

The basis of the allocation in that case is not relevant, because it was reached by mutual agreement, but the case is relevant as showing the propriety of an agreement on the subject.

Defendant, in a Position of Dominance, Appropriated Plaintiff's Loss and Is Subject to the Obligations of a Fiduciary.

Professor Scott says of quasi-contractual liability:

"In general one is entitled to recover for benefit conferred unless he intended to make a gift or acted officiously." (2 *Scott on Trusts*, Sec. 269.3, p. 1520)

How much more so is this true where one does not voluntarily confer the benefit but where it is taken by the defendant!

The situation may be likened to that involved in *Whiting v. Hudson Trust Co.*, 138 N.E. 33 (N.Y.). There an executor and trustee, having embezzled money from the estate, replaced it with funds diverted from another estate of which he was also executor. The first trust estate—guilty of no fraud—was held liable to the second on principles of quasi-contract. Judge Cardozo said (p. 8):

"The defendant's enrichment is a direct and immediate, not an indirect or collateral, consequence of the act of the trustee. It is an enrichment independent of the volition of the defrauded plaintiff or of those for whom he acts. The fruits of the tort are profits in the coffers of the estate. We cannot characterize enrichment so procured as other than unjust. * * * The trust is still augmented by assets unconscionably retained."

Plaintiff here made no gift of its loss to defendant. The latter simply took it. Even if plaintiff's directors had realized what was being done and even if they had had a donative intent, no gift could occur. The duality of position of plaintiff's representatives would preclude any claim of an effective corporate intent to make a gift. In addition, plaintiff's directors had no power to grant a gratuity, for stockholders' rights cannot be given away. *Brayton v. Welch*, 39 F. Supp. 537; *Greene County Nat. Farm Loan Assn.*

v. Federal Land Bank, etc., 57 F. Supp. 783. Here the real parties in interest are plaintiff's stockholders.

Plaintiff's rights are even greater, for here defendant in its conduct of the tax matters was a fiduciary toward plaintiff.

Where one corporation has been given or takes control over the property or affairs of another, and exercises it in a manner to obtain benefits for itself, it becomes accountable for those benefits, because control by the one over the property or affairs of the other creates a fiduciary duty not to use the control for the fiduciary's profit. In the *Shreveport Bank* cases that rule was applied where the benefits were tax savings. (See p. 36, supra.)

Note the mechanics whereby the defendant appropriated for its own benefit the tax credits resulting from plaintiff's loss. The operative documents which brought about this result were the consolidated tax returns for 1943 and for the first four months of 1944, the claim for refund of the 1942 taxes and the power of attorney from plaintiff to Polk. Defendant, through its tax counsel, prepared these documents. With them in hand, it was enabled to eliminate its tax liability to the extent of \$17,000,000 and did so. It filed the documents and settled the tax controversy with the government, all in plaintiff's name. All of these documents were signed by Curry as plaintiff's president. At the time he signed them he was vice president, assistant secretary and assistant treasurer of the defendant, with his headquarters in the office of the defendant (until May 1, 1945, when his headquarters were moved to the office of defendant's counsel), receiving his sole compensation from the defendant and following, in the signature of the documents, the directions of Polk, who was defendant's tax counsel and who, although he later solicited and secured a power of attorney from plaintiff, testified that he considered he owed his responsibility to the defendant and not to the plaintiff.

The decision to use the plaintiff's loss by way of offset to defendant's income was made by defendant through its president Elsey; and that decision was carried into effect by defendant's attorney, Polk, whose directions to execute the documents were

obeyed by Curry. Curry was completely subject to the control of the defendant and its attorney, Polk, and Curry and Polk considered themselves to be, and they in fact were, the hired hands of defendant. What they did with respect to the tax returns was in law the act of defendant. Insofar as tax matters were concerned, the defendant was in complete control of the plaintiff.

No clearer case of control by one corporation over the affairs of another, and no clearer basis for the imposition of the duties of a fiduciary, can be imagined.

Defendant was a fiduciary because at its own instance it voluntarily took over the conduct of plaintiff's tax affairs and assumed to deal with the plaintiff's property and rights in a manner designed to benefit itself.

It was a fiduciary because plaintiff's officers, whom defendant used to appropriate the plaintiff's loss, were defendant's employees and the employees of its tax counsel, and paid by it and them.

It was a fiduciary because it assumed to act as plaintiff's agent. While so acting, and by use of its principal's rights, and by taking advantage of its relationship to plaintiff, it received the \$17,000,-00 benefit.

One becomes another's fiduciary where he assumes to and does take over and manage another's affairs. The law of quasi-contract is derived from the Roman law, and one of the principal classes of quasi-contract was where one took over "the management of the affairs of another" or took over the "the management of common property." *Bouvier's Law Dictionary* (Rawle's Revision), title "Quasi-Contractus". *Sandars Edition of Justinian's Institutes* (7th Ed.) p. 385, Liber III, Tit. XXVII states:—

"if I take upon me the management of my neighbor's affairs * * * have things in common with others who are not my partners * * * the mere fact of my so conducting myself imposes on me certain duties which the law will force me to fulfill."

As said in *Commissioner of Internal Revenue v. Owens*, 78 F. 1 768, 773 (10 Cir.):

"The term fiduciary is derived from the civil law. * * It connotes the idea of trust or confidence. * * * The relation arises whenever the property of one person is placed in charge of another. *McKinley v. Lynch*, 58 W. Va. 44 51 S.E. 4, 9."

In the case cited (*McKinley v. Lynch*) the court quotes from several text writers thus:

"It is difficult to define the term 'fiduciary relation'; but it will probably be safe, without excluding other possible cases, to say that such a relation arises wherever a trust, continuous or temporary, is specially reposed in the skill or integrity of another, or the property or pecuniary interest, in the whole or in part, or the bodily custody, of one person, is placed in the charge of another'."

And again:

"The principles which cover the cases of dealings of persons standing in a fiduciary relation apply * * * generally, to the case of persons who clothe themselves with the character which brings them within the range of principal'."

In *Brooks v. Martin*, 2 Wall. (U.S.) 70, 84, the court notes the fiduciary character of one who manages a business for another "without consulting him in any way, and with little regard for his * * * interest * * *."

As said by Judge Cardozo in the famous case of *Meinhard v. Salmon*, 164 N. E. 545 (N. Y.), at 548:

"Salmon had put himself in a position in which thought of self was to be renounced, however hard the abnegation. He was much more than a co-adventurer. He was a managing co-adventurer. * * * For him and for those like him the rule of undivided loyalty is relentless and supreme."

As this passage shows, it is enough to create the fiduciary relation that one voluntarily places himself in control of another's affairs.⁷ *Southern Pacific Co. v. Bogert*, 250 U.S. 483, 492.

⁷*Bogert on Trusts* (part 1) p. 80, quotes from *Kochorimbus v. Maggos*, 154 N.E. 235, 238 (Ill.), where it was said, "A party may voluntarily assume a confidential relation towards another * * *".

In *Overfield v. Pennroad Corporation*, 42 F. Supp. 586, 48 F. Supp. 1008, a judgment of \$22,104,515 was entered in a stockholder's suit in favor of the Pennroad Corporation against the Pennsylvania Railroad and its directors, the court saying (at 42 F. Supp. 610):

"The liability of the defendants in this case is based upon their dealings with Pennroad's property and powers in a manner designed to benefit Pennsylvania Railroad."⁸

A mortgagee is not ordinarily a fiduciary to the mortgagor, but he is if he has control of the property. *DeMartin v. Phelan*, 115 Cal. 538, 543. Ordinarily a pledgee is not a fiduciary to the pledgor, but when he takes such control or dominance he becomes a fiduciary. Such was the holding in the *Shreveport Bank* cases, *supra*.

The term "fiduciary" is not confined to fixed classified relationships, like trusts or agency. It exists wherever confidence is reposed, particularly where there is a disparity of position. 3 *Bogert on Trusts* (part 1), pp. 82, 83. As further said in *Bogert*, p. 78), "Equity refuses to bind itself by an all-inclusive definition. It reserves entire freedom to declare relations to be fiduciary upon the particular facts of each case." Or, in the words of Judge Cardozo, "Equity refuses to confine within the bounds of classified transactions its precept of a loyalty that is undivided and unselfish". *Meinhard v. Salmon*, 164 N. E. 545, at 548.

In 1949 Professor Scott, the author of *Scott on Trusts*, delivered the Morrison Lecture at the California State Bar Convention, on the "fiduciary principle". He there called attention to a recent English decision, *Reading v. The King*, [1948] 2 K. B. 268, affirmed by the Court of Appeal in May 1949, in [1949] 2 K. B. 32. Reading, a British army sergeant stationed in Cairo, would parade in full uniform on trucks presumably carrying contraband.

⁸The Circuit Court of Appeals later held the claim barred by the statute of limitations but did not question the principles declared by the district court. The same issues were involved in an earlier stockholders' suit which was then revived and settled for \$15,000,000. *Perrine v. Pennroad Corp.*, 171 F.2d 479 (Del.).

His presence in uniform deterred the Egyptian police from investigating, and he was rewarded by large sums which he banked. The British military authorities learned of his bank accounts and seized them. Reading sued the Crown for a return of the money. The burden, said the court, was upon the Crown to establish its right to the funds, so that the case was the same as if the Crown had sued Reading.

The court held that the Crown was entitled to the funds, because the facilities provided by it in the shape of the uniform, and the use of the soldier's position in the army, were the reason why the payments were made to him.

It was further held that no fiduciary relationship was necessary to establish the Crown's rights, but, if one were necessary, it was present, for "the term 'fiduciary relation' in this connexion is used in a very loose, or at all events a very comprehensive, sense," and "in the wide sense in which the term is used in the relevant cases such a relation subsisted in this case as to the user of the uniform and the opportunities and facilities attached to it" ([1949] 2 K. B. at 236 and 238.)

It hardly need be added that the relation between parent and subsidiary corporation is fiduciary, if one dominates and controls the other. What gives rise to the fiduciary relation is the element of dominance and the exercise of control and management. *Southern Pacific Co. v. Bogert*, 250 U.S. 483, 492; *North American Co. v. S.E.C.*, 327 U.S. 686, 693.

Ordinarily, therefore, the parent is the fiduciary. Here, by reason of the moribund condition of plaintiff, its loss of control over defendant, the defendant's reinvigorated condition, the switch of allegiance of the James Interests to defendant, the fact that plaintiff's officers and most of its directors were mere employees of defendant and received their livelihood from it, the subsidiary dominated the quondam parent, and the defendant was the fiduciary. As said in *Commercial Nat. Bank in Shreveport v. Parsons*, 144 F.2d 231 at 236, "The dominant officers of the new bank were the directors of the old, and they were doubly bound to treat the latter fairly."

More than once a parent corporation has invoked and received the protection of fiduciary standards against unfair treatment at the hands of a subsidiary; e.g., *Potter v. Sanitary Co. of America*, 194 Atl. 87 (Del. Ch.); *Bancokentucky Co.'s Receiver v. National Bank etc.*, 137 S.W.2d 357 (Ky.).

As a Fiduciary, Defendant Must Account for Benefits Gained.

Once a fiduciary relationship is recognized, the rights and duties are similar to those existing in the case of a trust. As 4 *Pomeroy on Equity Jurisprudence* (5th ed.) 263 says:

"Wherever there is a fiduciary relation * * * the dealings of the parties with each other and with the subject-matter of the relation are governed by the same rules which determine the duties of actual trustees towards their cestuis que trustent * * *"

And as said in *Barney v. Saunders*, 16 How. (U.S.) 534, 542:

"It is a well-settled principle of equity, that wherever a trustee, or one standing in a fiduciary character, deals with the trust estate for his own personal profit, he shall account to the *cestui que trust* for all the gain which he has made."

Dean Roscoe Pound, in Pound and Plucknett's "Readings On The History And System Of The Common Law" (3rd Ed. 1927), at page 629, quoting Maitland's *Equity*, p. 83, refers to:

"* * * one grand rule. It is this: that wherever a person clothed with a fiduciary character gains some personal advantage by availing himself of his situation as a trustee, he becomes a trustee of the advantage so gained. * * *

"The rule includes persons who are not trustees properly so called, but all those who stand in what is called a fiduciary position. * * *"

This primary principle has been stated by the authorities in much the same language as respects every variety of fiduciary situation. Its gist and substance is this: The fiduciary may not avail

⁹Thus the rule of Cal. Civ. Code, Sec. 2235, concerning trustees is said to apply to all fiduciary relationships. *Metropolis etc., Sav. Bank v. Monnier*, 169 Cal. 592, 598.

himself of any advantage or facility that the position gives him. If he derives *any* benefit either from the use of any property or rights of the beneficiary or from the fact of the relationship or from the opportunities or facilities it affords, he must account to the beneficiary for the full benefit. All profits and advantages belong to the beneficiary, regardless of whether they spring from performance or from violation of the fiduciary's duty. The basic reason is that the fiduciary owes the duty of highest loyalty to his beneficiary, his personal interests must be utterly subjugated, "he must act with an eye single to the interest" of the beneficiary. And it matters not that the beneficiary has suffered no injury, that the profit was not made at his expense, or that he could not himself have made the gain. It matters not that the fiduciary acts in good faith or bad faith. Any other rule would tempt him to consider his own interest and put him in a position of conflict of selfishness with loyalty. Agreements altering these consequences may be possible, but they must follow "full disclosure of all relevant facts" and "an opportunity to obtain independent advice."

See *Restatement of Agency*, Sec. 387, 388; *Restatement of Trusts*, Sec. 203; 2 *Am. Jur.*, *Agency*, Sec. 268, p. 215; 3 *C.J.S.*, *Agency*, Sec. 165, p. 53; 3 *Scott on Trusts*, Sec. 502, p. 2422; 3 *Bogert on Trusts* (Part 1), p. 79.

In *Fleishacker v. Blum*, 109 F.2d 543 (9 Cir.) this Court said, "These high standards this court is not disposed to whittle down" (p. 547), in a case where a bank officer received a side consideration for procuring a loan of the bank's funds. He was held to account to the bank for the entire consideration, and this was said to be the rule "even though the bank has suffered no damage * * * and even though the officer may have acted in good faith." (p. 546).

These fiduciary rules are applied, as has been recently stated, "with particular stringency" to dealings between interlocking corporations. *Mayflower Hotel Stock. P. C. v. Mayflower Hotel Corp.*, 173 F.2d 416 (App. D.C., 1949).

The fiduciary principle has been applied to innumerable varieties of facts, many of which "do not fall readily into any general classification." (3 *Bogert on Trusts*, (Part 1) p. 153). As Bogert further says:

"The ways in which a fiduciary can take a position hostile to the trust and seek a private advantage are without number. In whatever form the disloyalty appears, equity penalizes it with the privilege in the cestui of obtaining a constructive trust of the advantage obtained by the wrongdoing trustee." (p. 156)

Thus the principle has been applied to compel an accounting of tax savings (*Shreveport Bank cases*, p. 36, *supra*) and of bribes (*Reading v. The King*, pp. 59, 60, *supra*).

In *Young v. Higbee Company*, 324 U.S. 204, a reorganization plan was proposed and confirmed by the District Court over the objection of two preferred stockholders that the plan was unfair. The two appealed. During the appeal they sold their stock and right of appeal for more than the market value of the stock. Other preferred stockholders thereupon sued them to obtain this profit. The Supreme Court held for the plaintiffs. The two stockholders, it said, had voluntarily become fiduciaries even though they had filed their objection on their own behalf and not on behalf of the preferred stockholders as a class, because success on the appeal would have redounded to the advantage of all. By appealing the two had assumed a "determining position over the rights of others" (p. 209) and "owed an obligation to them." (p. 210)

The plan of reorganization having been confirmed, the other preferred stockholders had lost nothing to which they were entitled. Yet it was held that the retention of the profit from the sale of their shares by the two stockholders was unjust; it "was not paid for anything they owned." (p. 212). So, in the present case, the tax saving now held by defendant was not the result of any tax credits belonging to it.

Duality.

We have referred to the authorities respecting duality of representation. There are numerous decisions delineating the equitable principles that govern.¹⁰

It will suffice to consider two decisions, namely, *Chelrob v. Barrett*, 57 N.E.2d 825 (N. Y. 1944), and *Overfield v. Pennroad Corporation*, 42 F. Supp. 586. These two contain a comprehensive discussion of the law and cite and review the leading cases. In both the courts took pains to declare the honesty and good faith of the officers, directors, and employees whose conduct was under review, and their firm belief in the propriety of their conduct. In both that honesty and good faith were said to be irrelevant and relief was granted.

The *Pennroad* case was a derivative suit by stockholders of Pennroad against the Pennsylvania Railroad. The complaint was that Pennroad's directors, in the management of its affairs, had not been solely guided by considerations affecting its welfare but had been, on the contrary, influenced by the interests of the Pennsylvania Railroad Company which had caused the Pennroad Corporation to be organized for the purpose of engaging in activities which it could not itself legally undertake. It appeared that the directors of the Pennroad Corporation were directors, officers or employees of the Pennsylvania Railroad, with a long history of loyalty to the latter company. It was held that this duality of obligation was sufficient ground for the recovery from Pennsylvania Railroad of all losses which had accrued to Pennroad as the result of investments made under the direction of these officers and directors, despite their unimpeachable integrity and good faith.¹¹

¹⁰For example, *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590; *Merger Mines Corporation v. Grismer*, 137 F.2d 335 (9 Cir.), cer. den. 320 U.S. 794; *Goodell v. Verdugo Canon Water Co.*, 138 Cal. 308; 3 *Fletcher Cyc. Corporations*, Perm. ed., Sec. 961, p. 433 434; *Globe Woolen Company v. Utica Gas & Electric Co.*, 121 N.E. 378 (N.Y.) (Cardozo, J.); *Eshleman v. Keenan*, 187 Atl. 25, 2 A.2d 904 (Del.); *Price v. Standard Oil Co.*, 55 N.Y.S. 2d 890, a case where a corporation's employees were mere employees (not directors) of another corporation.

¹¹In reaching this conclusion the court said:

"The occupation of two positions imposing different obligations at once raises a conflict of interest and duty and, due to the known

Chelrob v. Barrett, supra, involved a public utility system comprising three corporations: Long Island, Queens, and Nassau. Long Island owned the voting stock of Queens which owned the voting stock of Nassau. Queens expanded its plant to enable it to sell gas to Nassau. The price of the gas so sold was fixed by the directors of the two corporations, and all of them had been chosen by Long Island. A majority of the directors of Queens and of Nassau were also directors, and in some cases paid officers, of Long Island, and some of the directors of Long Island were also directors of Queens. Suit was brought by preferred stockholders of Queens who alleged that the price fixed by the directors was inadequate and unfair. Judgment was rendered directing additional payment to Queens.¹²

weaknesses of human nature, it is to be expected that in a majority of cases duty would be the loser in the conflict. * * * As said by Justice Cardozo (*Wendt v. Fischer*, 243 N.Y. 439, 443, 154 N.E. 303, 304), 'The law "does not stop to inquire whether the contract or transaction was fair or unfair. It stops the inquiry when the relation is disclosed * * * without undertaking to deal with the question of abstract justice in the particular case."' * * * *Only by this uncompromising rigidity has the rule of undivided loyalty been maintained against disintegrating erosion.*

"The same Judge in *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545, 546, 62 A.L.R. 1, declared that 'many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. * * * Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd'." (p. 608).

¹²The court said (p. 834):

"* * * the transaction is subjected to judicial scrutiny because the price was fixed by corporate boards having common directors elected by Long Island and these directors had been placed in a position of divided loyalty.

"The rule that must be applied in such a situation has been stated by the Supreme Court of the United States. 'The relation of directors to corporations is of such a fiduciary nature that transactions between

The case is of further interest because the court noted that so long as Queens and Nassau earned enough to pay dividends on the preferred stock, it was not material what price was charged for the gas, since the earnings of either eventually reached the ultimate parent, Long Island, the owner of the common stock. The problem arose only when earnings fell off so that dividends on the preferred stock went into arrears. Thus, in the present case, it would be unimportant whether the tax savings went to the Company or the Corporation so long as the latter owned the former. The severance of that tie created the problem.

The principles of duality apply to every variety of situation where the same person or persons represent two or more interests—e.g., agency (Cf. *Restatement of Agency*, Sec. 390, 392), trusts (Cf. *Restatement of Trusts*, Sec. 170), attorneys at law (Cf. *Peyton v. William C. Peyton Corp.*, 7 A.2d 737, 747 (Del.)); *Re James Estate*, 86 N.Y.S. 2d 78 (1948). They were applied in *Bernheim v. Louisville Property Co.*, 214 S.W. 801 (Ky.), which is of particular interest because it involved common agents and officers of two corporations which had formerly been affiliated but whose interests had been severed. The court remarked on the failure of the individuals occupying dual positions to appreciate that "the severance of 1908 in reality changed the relationship between the two companies."

C. PLAINTIFF'S RIGHT TO RECOVER RESTS ON BENEFITS CONFERRED AND IS NOT CONFINED TO DETRIMENT SUSTAINED.

Fundamentally, the argument of defendant below, by which it seeks to retain unjustly the \$17,000,000 benefit which it obtained by use of plaintiff's rights, was that plaintiff suffered no

boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation, * * * Especially is this true where a common director is dominating in influence or in character. This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality, and we now add in the soundest business policy.' *Geddes v. Anaconda Mining Co.*, 254 U.S. 590, 599, 41 S.Ct. 209, 212, 65 L. Ed. 425."

damage or detriment from defendant's appropriation of those rights. This is based on the fact that plaintiff itself happened to have no income in the years in question against which it could have offset its loss had defendant not utilized that loss to offset its own income. (See p. 52, *supra*.)

The argument is tantamount to the claim that because the plaintiff was poor and had no other income, anyone who could utilize its valuable rights could appropriate them without payment and with impunity. It is equivalent to saying that if a man should lose one leg and be possessed of a shoe that he could not use and that would fit only one other person in the community, that other person could take the shoe without payment. Or that if A is given a library of Sanskrit manuscripts and no one but B exists in the land who can read Sanskrit, B may take the library with impunity because A has "suffered no damage."

The short answer is that a plaintiff's rights in an unjust enrichment case are measured by the benefits conferred, received or taken—not by the detriment suffered. A plaintiff recovers because of benefits obtained by the defendant, and those benefits measure the recovery. *Restatement of Restitution*, Section 1, and comment. In the comment it is said:

"Ordinarily the benefit to the one and the loss to the other are co-extensive, and the result of the remedies given under the rules stated in the Restatement of this Subject is to compel the one to surrender the benefit which he has received and thereby to make restitution to the other for the loss which he has suffered. * * * (p. 13)

* * * * *

"In other situations, a benefit has been received by the defendant but the plaintiff has not suffered a corresponding loss or, in some cases, any loss, but nevertheless the enrichment of the defendant would be unjust. In such cases, the defendant may be under a duty to give to the plaintiff the amount by which he has been enriched." (p. 14.)

Similarly, where a fiduciary gains a profit from the fiduciary relationship, it belongs to the beneficiary, regardless of whether

the latter could have made it independently.¹³

It is elementary, as said in 3 C.J.S., Sec. 165, p. 54, that the application of the fiduciary rules discussed at pp. 61-63, supra, "is not affected by the fact that the principal did not suffer any injury by reason of the agent's dealings * * *."

Or, as said in 3 *Scott on Trusts*, Sec. 502, page 2422:

"It is immaterial that the profit was not made at the expense of the beneficiary or principal; * * *".

To the same effect are 2 *Scott*, p. 1098, and 54 *Am. Jur.* 249.

In *Fleishacker v. Blum*, 109 F.2d 543 (9 Cir.), this Court held that the bank in whose behalf a stockholder's bill had been brought was entitled to recover certain profits "even though the bank has suffered no damage."

Such was the situation in the *Shreveport Bank* cases discussed at pp. 36-38, supra. There the Old Bank not being engaged in business, it would have had no tax on its stock, and therefore it had no occasion to use the value of its real property for its own tax benefit. Moreover, the New Bank's false representation to the State that the property belonged to it did not destroy the Old Bank's rights to use its property in any tax returns it might have to make.¹⁴ Yet, as there said: "The fact that the Old Bank suffered no loss * * * makes no difference." *Leslie v. Commercial Nat. Bank of Shreveport*, 28 F. Supp. 927 at 933. In the first appeal in that case the dissenting judge commented: "The transaction left the old bank no worse off. It was not injured in the least by the transaction * * *." 144 F.2d at 245. Yet on the second appeal the same judge wrote the opinion of the court affirming the right

¹³Restatement of Restitution, at p. 15 states:

"So also, where a person in a fiduciary relation to another makes a profit in connection with transactions conducted by him as fiduciary, he is ordinarily accountable to his beneficiary for the profit, although the beneficiary suffered no loss."

¹⁴In the present case, the use by defendant of plaintiff's tax rights in consolidated returns legally precluded plaintiff from using the same tax credits in later separate returns.

of the old bank to recover such of the tax savings as were attributable to that class of property which it held belonged to the old bank.

In *Reading v. The King*, [1949] 2 K. B. 232, discussed at pp. 59-60, *supra*, the Crown was held entitled to bribes received by a soldier although it had sustained no loss and it could not itself have earned the sums involved.¹⁵ The court held that the Crown could recover "whether or not [it] had suffered any detriment in fact"; and that the defendant "cannot be heard to say that * * * the plaintiff suffered no loss. The plaintiff, whether actually harmed or scathless, is conclusively presumed not only to have been damnified but to have been damnified to an extent measured by the amount" of defendant's enrichment.

In the *Consolidated Electric-Islands* case, discussed at p. 46, *supra*, losses of Islands, one of the affiliates, resulted in a tax saving to the affiliated system. The S.E.C. recognized that "none of this saving can be realized directly by Islands since it does not have the taxable net income against which to offset such losses" (13 S.E.C. at 652). While it was noted that the use of the loss for tax purposes might, in a future contingency, result in a tax liability to Islands, it was also noted that "any tax liability resulting to Islands * * * will be considerably less than the tax savings to be presently effected." Nevertheless, it was held proper that the whole of the tax savings should be paid to Islands by the other affiliates which achieved the savings by use of Islands' loss in consolidated tax returns.

A striking application of these rules of unjust enrichment will be found in the *Kentucky Cave* case, *Edwards v. Lee's Adm'r.*, 96 S.W.2d 1028 (Ky. 1936). There Edwards had discovered a cave the entrance to which was on his land. By years of advertising and exploitation he spread the fame of the cave, built a hotel near its mouth, improved the cave, and eventually secured a stream of

¹⁵It is interesting to note that the sergeant's counsel recognized that under the law of "unjust enrichment" it was unnecessary that a plaintiff suffer damage, but he argued that "unjust enrichment", though a recognized part of American law, was not part of English law.

tourists whose entrance fees yielded him a good profit. Without his efforts the cave would have remained useless.

After the cave became profitable, a neighbor, Lee, sued on the ground that approximately $\frac{1}{3}$ of the length of the cave underlay his land and recovered judgment requiring the defendant to account to the plaintiff for $\frac{1}{3}$ of the net proceeds received by the defendant from exhibiting the cave over a space of 7 years, with 6% interest.

The Supreme Court of Kentucky affirmed the judgment although it recognized (1) that plaintiff merely had a hole in the ground which he himself could not use because it was so far beneath the surface that it could not be entered except through the natural mouth on defendant's property; (2) that the cave was therefore of no practical use to the plaintiff; (3) that for the same reason there was no one in the world other than defendant himself upon whom the plaintiff might confer a right of beneficial use of the portion of the cave under his property; (4) that consequently plaintiff's portion of the cave had no utility to him, it had no sales or rental value, and plaintiff had not been ousted of the physical occupation or use of his property because he could not and did not occupy it; (5) that the property had not in any way been injured by the use to which defendant had put it, and (6) that plaintiff had suffered no loss or detriment.

The court stated that, as the case was *sui generis*, it was left to fundamental principles and analogies. It reasoned (1) that plaintiff had something (a definite segment of the cave) and therefore was possessed of a right which it was the policy of the law to protect; (2) that the action was in equity for an accounting; and (3) that the "measure of recovery in this case must be the benefits, or net profits, received by the appellants from the use of the property of appellees," by way of analogy to the rule of Section 136 of the *Restatement of Restitution*.

The court refused to treat the case as one of trespass, for the reason that, had it done so, there could be no recovery for lack of "damage"; the property had not been injured, and there was

no rental value since plaintiff had no access to the cave, could not use it, and there was no ouster of possession.

In the present case, bearing in mind that the defendant simply appropriated the plaintiff's tax credits without discussion and without any consideration for the existence or rights of the plaintiff, Section 136 of the *Restatement*, relating to benefits tortiously acquired, is also applicable. In the comment under that section, it is said:

"In some cases, however, no harm is done and in these cases if the sole remedy were by an action of tort the wrongdoer would be allowed to profit at little or no expense. * * * The usual method of seeking restitution is by a bill in equity with a request for an accounting for any profits which have been received * * *." (p. 553)

Even where a defendant has not acted in a manner that is considered to be tortious, he may have to account under the principles of quasi-contract. *Restatement of Restitution*, Ch. 6. The law on the subject is not static or confined to ancient categories.¹⁶

In *Truncate v. Universal Pictures Co.*, 76 F. Supp. 465, directors of a corporation held options to buy from it shares of its stock at a fixed price. Under tax law and regulations, if such an option is exercised at a time when the market price exceeds the option price, the excess is taxable income, but the corporation may deduct the excess in computing its own tax. In order to secure a closing agreement from the Commissioner of Internal Revenue that the excess, in the event the options should thereafter be exercised, would not constitute taxable income to the directors, the latter caused the corporation to agree with the Commissioner that in computing its own income it would not deduct the excess.

¹⁶As said in the *Restatement*, at page 493:

"The situations dealt with in this Chapter do not exhaust all those in which restitution can conceivably be granted for benefits lawfully acquired. They represent situations which have arisen, and indicate the type of situations in which restitution should be granted."

Closing agreements to this effect were executed, and the options were then exercised.

As a consequence, the corporation paid more taxes than it should have, and the tax liabilities of the directors were diminished. However, the losses suffered by the corporation were much less than the gains enjoyed by the directors, since each director had his own outside income and the amount of his tax savings was affected by his own tax bracket.

A stockholder's derivative action was brought against the directors to compel them to account to the corporation not merely for the amount of the losses suffered by it, but for the entire tax savings of the directors. Defendants moved for a summary judgment on the ground of the statute of limitations. This turned, under New York statutes, on whether recovery was limited to the loss suffered by the corporation or extended to the entire gain enjoyed by the defendants. The court (Rifkind, J.) held the latter. Remarking that the situation was unique, it said (p. 469):

"* * * where a corporation has the freedom to do an act or to refrain, the doing of the act, enabling others to derive benefits in excess of the losses suffered by the corporation, has a 'sale' value of which the ceiling is the amount of such benefits; * * *."

Plaintiff's rights here are far stronger than that of the corporation in *Truncate's* case. There the corporation had nothing to contribute, and possessed nothing, other than the power to refuse to enter into the closing agreement. Here plaintiff possessed not only the power to decline to enter into consolidated returns, but by entering into such returns it contributed something that belonged to itself, to wit, its own tax credits worth \$17,000,000.

Closely related to defendant's argument that plaintiff was not damaged is its argument that plaintiff's tax credits could not be sold generally to those desirous of making tax savings. From this fact it argues that plaintiff has no right of recovery.

It is true that the plaintiff's loss could be used to offset income of someone other than itself only in a consolidated return and therefore could be availed of only by defendant or another of the affiliates. But the fact is irrelevant.

Thus in the *Shreveport Bank* cases, *supra*, only the new bank was able to make use of the tax credit. In *Truncale v. Universal Film Exchange*, *supra*, no one but the directors were able to make use of their corporation's situation. In the absence of utilization by them the corporation could not have realized the benefits which they received. In the *Kentucky Cave* case, in all the world only the defendant could make use of plaintiff's part of the "hole in the ground".

The fact, then, that a particular asset or right has a limited utility or "market", or that no one can use it except one party, does not destroy its value or give that party the right to appropriate it without incurring liability.

For example, the government may be the only possible buyer of a given property and unless it sees fit to buy, the owner may have no way to utilize the property or to realize upon it. But that fact does not destroy its value. In *James v. Campbell*, 104 U.S. 56, 358, the court noted that "Many inventions relate to subjects which can only be properly used by the government, such as explosive shells, rams, and submarine batteries to be attached to armed vessels," but observed that the government could not use such patented inventions or the patents without paying just compensation.

In the field of eminent domain generally, the fact that property has no general market and that therefore there is no market value does not eliminate its value. As said in *San Diego Land etc. Co. v. Neale*, 78 Cal. 63, 68,

"But it is certain that a corporation could not for that reason appropriate it for nothing."

and as said in *Boom Co. v. Patterson*, 98 U.S. 403 at 408:

"Property is not to be * * * regarded as valueless because he [the owner] is unable to put it to any use. Others may be able to use it, * * *."

In the patent field many an invention consists of an improvement or addition to a machine or process on which another owns the patents, and it has no utility except as part of that machine or process, so that no one except the owner of the machine or process can make economic use of it. Yet the latter cannot appropriate the new invention without paying for it. As said in *Bigelow v. R.K.O. Radio Pictures*, 327 U.S. 251, 265, if "a wrongdoer has incorporated the subject of a plaintiff's patent or trademark in a single product to which the defendant has contributed other elements of value or utility, and has derived profits from the sale of the product," not only must he pay but he may have to account for all his profits. Cf. *Westinghouse Co. v. Wagner Mfg. Co.*, 225 U.S. 604.

Defendant has argued that what plaintiff had was a loss, that a loss is a "negative" thing, that it cannot be called an "asset", and that therefore plaintiff has no right of recovery.

Plaintiff not only had the loss, it had the right to make use of it for tax purposes and the right to permit or withhold consent to its use in consolidated returns. It is of no relevance whether plaintiff's \$75,000,000 loss, its right of use, or its right to withhold consent to the use of a consolidated return whereby the loss could be utilized, can be denominated "property." Terminology, such as "property," is not the source of legal or equitable rights. The reverse is true: in the long history of Anglo-American law the recognition that a right exists and its entitled to legal protection has been the starting point of recognition of new kinds of property rights.

In *U.S. v. Willow River Co.*, 324 U.S. 499, a plaintiff claimed a right to recover by denominating something as "property". The court said (at p. 502): "We cannot start the process of decision by calling such a claim as we have here a 'property right'; whether it is a property right is really the question to be answered."

It is equally question-begging to try to defeat a recovery by asserting that there is no property right involved.¹⁷

¹⁷In *Matarese v. Moore-McCormack Lines*, 158 F.2d 631 (2 Cir.), defendant made use of an idea of the plaintiff. The idea was not only an in

As was said in the recent case of *Johnston v. 20th Century-Fox Film Corp.*, 82 C.A.2d 796, 817:

"As society has developed there has been a corresponding evolution in the development of property rights. Matters considered as near revolutionary a few years ago are now accepted as facts. Legal history shows a continual recognition of new interests and a gradual willingness to protect interests in intangible things. (Warren & Brandeis, 4 Harv. L. Rev. 193; 4 Ford. L. Rev. 307; 45 Yale L. J. 520)".

The famous article of Mr. Louis Brandeis (later Mr. Justice Brandeis) and Mr. Samuel Warren just referred to, which first appeared in 4 Harvard Law Review in 1890, entitled "The Right to Privacy", contains a masterly discussion of the subject. (See particularly pp. 193 to 195, and p. 212).¹⁸

In the present case, whatever it may be denominated or however it may be characterized, the loss was plaintiff's, it carried with it the right of use in certain situations to achieve tax savings, and that right belonged to plaintiff. Defendant appropriated that right and thereby achieved a \$17,000,000 saving, and it should now account to plaintiff.

The principles on which plaintiff is entitled to recovery are not novel; they are fundamental. All that is novel in the case is the unique factual situation. But equity is not powerless to cope with unusual facts.

The Right to Recover Does Not Require a Contract.

At pages 53, 54, supra, we showed that an agreement concerning the equitable apportionment of the tax savings would

be unenforceable, it was unpatentable. Thus plaintiff had no "property right". Defendant was compelled to account for the savings it achieved in the cost of doing longshore work resulting from the use of the idea.

¹⁸As was stated by Chief Justice Shaw of Massachusetts (in *Boston and Lowell Railroad Corporation v. Salem and Lowell Railroad Co., et al.*, 6 Gray (68 Mass.) 1, 35 (1854)), the term "property"

"is *nomen generalissimum*, and extends to every species of valuable right and interest, and includes real and personal property, easements, franchises and incorporeal hereditaments."

have been perfectly valid. But plaintiff's rights to recover do not depend on whether such an agreement was or could have been made.

As said in 2 *Bouvier's Law Dictionary*, 803 (Rawle's Revision), under "Quasi-contracts":

"In quasi-contract the obligation arises not from consent, as in the case of contracts, but from the law or natural equity."¹⁹

In *Reading v. The King* [1949], 2 K. B. 232, discussed at pp. 59, 60, *supra*, no valid prior contract to share bribes would have been possible. In the *Shreveport Bank* cases, discussed at pp. 36, 38, *supra*, no valid contract would have been possible between the Old Bank and the New Bank to report the former's property as the latter's in order to save taxes.

And as we shall show, at pages 84-86, *infra*, a fiduciary must account to his beneficiary for his gains even though made in an illegal enterprise. Yet a prior agreement on the subject would not be permissible.

II.

THE TRIAL COURT'S REASONS FOR DENYING RELIEF TO PLAINTIFF ARE ERRONEOUS

The court's reasons for denying relief to plaintiff have nothing in common with defendant's arguments for denial of relief. In deed, the principal ground of the court's decision is offensive to

¹⁹In *Matarese v. Moore-McCormack Lines*, 158 F.2d 631 (2 Cir.)

"The doctrine of unjust enrichment or recovery in quasi-contract obviously does not deal with situations in which the party to be charged has by word or deed legally consented to assume a duty toward the party seeking to charge him. Instead, it applies to situations where as a matter of fact there is no legal contract, but where the person sought to be charged is in possession of money or property which in good conscience and justice he should not retain, but should deliver to another. * * * Where this is true the courts impose a duty to refund the money or the use value of the property to the person to whom in good conscience it ought to belong." (p. 634.)

defendant, for it is tantamount to accusing it of improper conduct that should be investigated.²⁰

The court based its decision on two lines of reasoning, a major ground and a minor. The major one was its belief that the tax savings ought not to have been allowed by the Treasury. The minor one was the view that plaintiff was seeking to obtain something denied it under the Reorganization Plan.

These two bases on which the court has denied relief to plaintiff are mutually inconsistent. In the first place, they are bottomed on incompatible attitudes toward the court's own power and its exercise. In denying relief on its second line of reasoning the court does so on the ground that it ought not to go behind final administrative and judicial determinations. Truly, it ought not. But in denying relief on the ground that the tax savings should not have been allowed by the Treasury, the court has in fact done exactly that: it has gone behind a final administrative determination. Yet in the situation to which it would apply the principle that it could not do so, the principle has no application, for a judgment for plaintiff would have no such effect, as we show at pages 88-85, *infra*.

The two lines of reasoning are incompatible for another reason. In one breath the court asserts that the tax savings were "amazing and undeserved", that the tax should have been paid to the Treasury, and that it would order defendant to pay the \$17,000,000 to the Treasury, if it had the power to do so. In the next breath, it asserts that payment of these very moneys to plaintiff will militate against the "resuscitation" of the defendant railroad and thus defeat the Reorganization Plan. Yet the first observation recognizes that the "resuscitation" of this railroad did not involve the retention of these moneys by defendant.

Neither of the District Court's two lines of reasoning is sound, as we now proceed to show.

²⁰Thus the Court said in its opinion that the tax saving "invites a type of scrutiny which this Court is powerless to give it." (270)

A. IT WAS IMPROPER TO DENY RELIEF TO PLAINTIFF ON THE BELIEF THAT THE TAX SAVING OUGHT NOT TO HAVE BEEN ALLOWED BY THE TREASURY.

We commented on this reasoning at p. 47, *supra*. As we there said, for defendant Company to keep the tax saving would be a subversion of the tax law. The trial court believed that *defendant* had wronged the government. Yet, for that reason it has denied recovery to the plaintiff and thereby has rewarded the defendant by permitting it to keep the gain. This is contrary to the maxim, "No one can take advantage of his own wrong." *Cal. Civil Code*, Sec. 3517.

There are several evident inadequacies in the trial court's conclusion, each sufficient to invalidate it:

(1) The tax deductions were in accord with law.

(2) The allowability of the tax deductions was not an issue in the case and was not open to question here.

(3) Even if the deductions should not have been allowed, that fact does not justify denial of an accounting by defendant to plaintiff.

The Tax Procedure and Deductions Were in Accord with the Law.

In the first place, the conclusion that the filing of consolidated returns and the use of plaintiff's loss to offset defendant's income were not permitted by tax law and regulations, as respects the government, is not sound.

The rational basis of allowing consolidated returns is the existence of an economic entity. But, in providing for the situation, Congress chose to establish certain ready and less subjective tests. Corporations are "affiliated" when 95% of the voting power of all classes of stock and 95% of each class of non-voting stock, except limited preferred stock, are owned by one or more of the corporations in the group. Internal Revenue Code, Sec. 141. Plaintiff and defendant were affiliated within that statutory test until April 30, 1944. And Section 23(g)(4) of the Internal Revenue Code permitted a parent's loss resulting from worthlessness of stockholdings to be used as a deduction. The regulations also

permitted consolidated returns to be filed although one or more affiliates were in bankruptcy (see p. 43, *supra*).

The statutory tests for tax deductions existing, they govern, and the courts do not go behind them.²¹ For example, in *Trinity Buildings Corporation of New York*, 40 B.T.A. 1315, one of an affiliated group of corporations was in bankruptcy, and thereby its control was out of the hands of the parent. The trustee refused to join in consolidated returns. Under the regulations all affiliates must join, and the Commissioner therefore refused to recognize a consolidated return joined in only by the others. He was upheld, the Board of Tax Appeals saying:

"Looking alone, therefore, at section 52 and section 141, it seems clear that the bankrupt corporation was, by reason of the Realty Co.'s ownership of its shares, a member of the affiliated group * * * and that this is none the less so because the shares of the bankrupt corporation may have been worthless or because its business and properties were being operated by a trustee in bankruptcy." (p. 1319)

George A. Fuller Co. v. Commissioner of Internal Revenue, 92 F.2d 72 (2 Cir.), involved the same question for the same group of corporations for another year. The Court arrived at the same decision as the Board in the *Trinity* case.²²

**Whether the Tax Saving Should Have Been Allowed
by the Treasury Was No Issue in This Case.**

In the second place, whether the tax savings should have been allowed by the Bureau of Internal Revenue was not an issue in

²¹*Commissioner v. Korell*, 339 U.S. (prelim. print.) 619, 625, 626.

²²It said:

"Though it is clear that there was no actual compliance with the condition imposed by the statute [joinder by all affiliates] the petitioner insists that where the failure to comply is due to the refusal of a trustee of one of the group in bankruptcy whose action is, therefore, not subject to the common control which might otherwise prevail a consolidated return may properly be filed for the remainder of the group.

"The plain answer to such a contention is that it is contrary to the statute." (p. 73.)

the case, and the court below had no right to question it. This case *starts* with the fact that there *were* tax savings. Their *existence* is part of the factual context of this litigation. The sole issue was who is entitled to the tax savings as between plaintiff and defendant.

Here a federal tax question had been determined by the proper administrative officials, and the determination and tax settlement had become final before the judgment was entered below and no longer could be questioned by the government (see p. 23, *supra*). The Bureau of Internal Revenue, not the court, was the instrumentality selected by Congress for the purpose. In *Bull v. United States*, 295 U.S. 247, 259, the Supreme Court said:

"The statute prescribes the rule of taxation. Some machinery must be provided for applying the rule to the facts in each taxpayer's case, in order to ascertain the amount due. The chosen instrumentality for the purpose is an administrative agency whose action is called an assessment. The assessment * * * may include the calculation and fix the amount of tax payable, and assessments of federal estate and income taxes are of this type."

The tax laws authorize the Commissioner to enter into compromises. And as said by the Attorney General (31 Op. Atty. Gen. 459), it is *his* power to do so "where, in *his* judgment, such compromises were for the interests of the United States."

A determination by the instrumentality chosen by Congress to make it is not lightly to be questioned, even in case of a direct attack. As said in *In Re Epstein*, 4 F.2d 529, 530 (6 Cir.), "courts do not lightly set aside a construction, by a department of the government, of a statute peculiarly relating to the duties and powers of that department * * *" And in *U. S. v. Pierce Auto Lines*, 327 U.S. 515, an appeal from a decision of a three-judge district court suspending an order of the Interstate Commerce Commission, the court said:

"We think the court misconceived not only the effects of the Commission's action * * * but also its own function. It is not true, as the opinion stated, that * * * 'the courts must

in a litigated case, be the arbiters of the paramount public interest.' This is rather the business of the Commission, made such by the very terms of the statute." (p. 535)

Such is the law in case of a direct attack. Where the attack is not direct but merely collateral, arising in a different kind of lawsuit merely because the results of the tax determination are involved as one of the facts of the case, no court can question the propriety of the determination. Cf. *In re Kaufman's Estate*, 30 N.Y.S. 2d 616; *In re Mayer's Estate*, 22 N.Y.S. 2d 468.

In the present case there was not even a collateral attack, much less a direct one, for neither plaintiff nor defendant has questioned the tax determination.

If settlement had not been effected with the Commissioner but the matter had been litigated through the Tax Court, and if that court had decided in favor of the tax deduction here involved and its decision had been allowed to become final, certainly the court below could not in this case have questioned the adjudication for any purpose whatever. No more can it do so now.

Indeed, an income tax "assessment is given the force of a judgment." *Bull v. United States*, supra, at p. 260.

In *Galbraith v. Devlin*, 148 Pac. 589 (Wash.), an action for an accounting by one partner was instituted against others. One defense was that the plaintiff did not have clean hands because he had made certain misrepresentations to one who was collaterally interested in the transaction. The court held for the plaintiff. It said (p. 592):

"If Harvey was satisfied, no one else can complain for him."²³

Further, the procedure of tax settlement was legal in every regard. Full disclosure was made to the Bureau of Internal Reve-

²³Cf. *Langley v. Devlin*, 163 Pac. 395 (Wash.), where a defendant resisted an action for an accounting on the ground that a third party had been wronged. The court said, "The third party is not complaining." It further said that for a court of equity to deny relief, "because of a fraud affecting a third party or a right 'would lead to the absurd consequence that a defendant in a suit would take a decree equivalent in its legal force to affirmative relief under the plea of corrupt participation.'" (p. 401.)

nue in great detail. In May 1946, Polk, the tax counsel, wrote the first "Krigbaum letter" to the Internal Revenue Agent in Charge which explained exactly how the loss occurred (1779 P 64). It stated the facts showing the severance of the economic unity between plaintiff and defendant and the dates. A year later he wrote the second Krigbaum letter (1799 P 71).

The Treasury's audit and examination of the tax returns took over a year and a half (1419, 1788). Negotiations for settlement extended over six months. They occurred first with the agent in charge, and then with the Commissioner of Internal Revenue in Washington where several conferences were held, presided over by the technical adviser to the Commissioner. The history is reviewed in the record at pages 1788-91, in plaintiff's Exhibit 68. Indeed, when Polk sought on the witness stand to give a full review of the negotiations with the government, he was shut off by the trial court of its own motion with the remark,

"I just can't see what purpose is served by these long discussions as to what took place in a conference in Washington over subject matter where the results are before the court, and it doesn't seem to serve any useful purpose."
(1428)

This observation during the trial was sound. The court should never have departed from it.

For the trial court in this case to refuse to inquire into the merits of the case *as between plaintiff and defendant* because of a belief that the tax settlement was "phony", as the court expressed it (423), was, we submit, not permissible.

**Even if the Tax Deductions Were Improper, That Would
Be No Reason to Deny Relief to Plaintiff.**

The reasoning on the basis of which the court below denied plaintiff an accounting because of its belief that the government should not have allowed the tax deductions is so elusive that it is difficult to find the legal category in which to appraise it or by which to test its soundness. But no matter how viewed, it is still unsound.

If the trial court had in mind that a court will not intervene between two joint wrongdoers, that doctrine has no application to the facts of this case. The tax matter was handled by defendant and its counsel in its entirety, and plaintiff was not a participant in the handling of the tax returns and the settlement. The court so found (see pp. 8, 9, *supra*), and during the settlement of the findings it stated what it meant by its findings on this score as the following colloquy shows:

"Mr. Lasky: * * * Your Honor's opinion in major part, as we understand it, decided the case on the basis that the taxes ought to have been paid the government; that the settlement, to quote from the opinion, 'invited a type of scrutiny that the court could not give it,' and that if you were able to do so, you would set it aside. 'The tax escape was erroneous and unjust.' More of that quotation. And consequently, the court of equity would decline to interevene.

"As has been indicated so far this afternoon, that sounds on the principle that the court will not interfere between wrongdoers, or possibly like the doctrine of unclean hands.

"So the first group of requested findings, three, four, five, six, seven and nine are directed to this. In essence, they go to the fact that the plaintiff is not in *pari delicto*; that the plaintiff did not itself conduct the tax transaction.

"* * * This merely goes to the point that the plaintiff itself did not conduct the tax operations, had nothing to do with them until the time of settlement, so that if there is some wrongdoing involved there we were not in *pari delicto* on it. The facts we present are all true." (462)

* * * * *

"* * * the tax settlement was conducted by defendants' tax counsel, so that the plaintiff itself, if there were any impropriety, if there were wrongdoing, if this doctrine of unclean hands applies, then we do not come in; we were not in *pari delicto*." (465)

* * * * *

"* * * the evidence certainly discloses that the tax operations, however they may be characterized, were conducted by the defendant and its tax counsel, not by the plaintiff. "The Court: There is no question about that." (468)

* * * * *

"The Court: Don't you think that most everything you have mentioned is really in the opinion some place or another? You are right, perhaps in proposing it in orderly concise form." (476)

It is a settled rule of equity that if one person uses property or rights of another to make a profit, particularly if he is a fiduciary, the other person—owner or beneficiary—is entitled to the profits even though they have emanated from an illegal or improper enterprise in which the property or rights were embarked. The fiduciary cannot escape accounting on the plea of illegality of the enterprise.

Thus in *Barney v. Saunders, et al.*, 16 How (U.S.) 534, the Supreme Court reversed a judgment that refused to compel trustees to account for usurious interest received. It said:

"They cannot be allowed to aver that the profits made on the trust fund should be put in their own pockets, because they were unlawful gains, for fear that the conscience of the cestui que trust should be defiled by participation in them. To indulge trustees in such an obliquity of conscience, would be holding out immunity for misconduct and an inducement to speculate with the trust funds, and put them in peril." (p. 543)

In the *Shreveport Bank* case, discussed at pp. 36-38, *supra*, the new bank used as tax deductions for state tax purposes certain property belonging to the old bank. In achieving its tax deductions the new bank made false reports to the state, that is to say, it reported and represented that the property was its own. Its tax savings thus rested on a false statement of fact. Had the truth been reported, the state would not have allowed the deductions, as the district court stated (28 F. Supp. 927, 933). Consequently, on the first appeal (144 F.2d 231) Judge Waller dissented from the decision that the new bank must account to the old bank for the tax savings. His opinion expressed all the views that permeate the opinion of the court below in the present case. He said (p. 245):

"As a result of the shrewdness of the new bank, plus the stupidity, or cupidity, of the taxing authorities, the new bank was allowed to take a deduction in its capital stock assessment to the same extent as if it had been the real owner of the old bank's real estate. * * *

"All parties seem to have proceeded on the theory that it was all right to gyp the State of Louisiana but some think it wrong to gyp the old bank."

Yet on the second appeal Judge Waller wrote the opinion of the entire court en banc upholding the old bank's right to recover. *A fortiori*, the plaintiff should recover here. In the *Shreveport* case, the tax deduction was based upon a false statement of fact. Here there were no false statements to the tax authorities. The latter knew the facts, and the court below believes merely that the legal conclusions of the tax authorities as to the tax consequences were erroneous.

In *Reading v. The King*, discussed at pages 59-60, supra, the Crown was held entitled to moneys received by an army sergeant for bribes received in assisting violations of the law of Egypt. Patently the profits resulted from an illegal enterprise, and the Crown itself could not have engaged in that enterprise. The court held that illegality was no bar to the Crown's rights. It held that the law did not imply a promise "in advance of the event by the soldier to hand over any price which he might receive, which would be invalid for illegality, but a promise made, after the price had been received * * * to hand the amount of the price over."

This is in accord with what Mr. Justice Story said in 3 *Story's Equity Jurisprudence* (14th Ed.) Sec. 1663, p. 303:

"One of the most common cases in which a Court of Equity acts upon the ground of implied trusts in invitum is where a party has received money which he cannot conscientiously withhold from another party. It has been well remarked that the receiving of money which consistently with conscience cannot be retained is in equity sufficient to raise a trust in favor of the party for whom or on whose account it was received. This is the governing principle in

all such cases. And therefore whenever any interest arises, the true question is, not whether money has been received by a party of which he could not have compelled the payment, but whether he can now, with a safe conscience, *ex aequo et bono* retain it."

Here, the question is not whether defendant could properly achieve the tax savings. It *has* achieved them, and the question is whether it may now retain them vis-a-vis the plaintiff.

In *Daniel v. Daniel*, 198 Pac. 728 (Wash), the owner of an undivided interest in property sued for an accounting of profits. Defendant resisted on the ground that most of the profits came from leasing the premises for purposes of prostitution. The court noted a division in the authorities as to the right to enforce a sharing of profits from an illegal enterprise, as between the participants, but said that the factual situation was different.

"We cannot, however, concede that the present case falls within the rule sought to be invoked. The respondent was in this instance in no sense a party or privy to the illegal transaction through which the profits she seeks to recover were gained. At the time they were gained the appellant was holding and managing the property as his own, without recognition of any right therein in the respondent, and it was wholly because of his individual act that the property was put to an immoral use. To require him to account for the profits gained is not, therefore, to enforce an illegal transaction to which the respondent was at one time a party; it is but to require him to account for money acquired by the wrongful use of her property. To refuse to require the accounting would be to punish the innocent, rather than the guilty party, and this is not the purpose of the rule relied upon. Its purpose is to discourage illegal transactions and, when this purpose is better subserved by recognizing and enforcing the transaction than it is by ignoring it courts have never hesitated so to do." (p. 730)

And see *McBlair v. Gibbes*, 17 How. (U.S.) 232.²⁴

²⁴See also, in *Memphis & Arkansas City Packet Co. v. Agnew*, 17 S.W. 949 (Tenn.). There the defendant was the captain of plaintiff

In denying the plaintiff recovery because it felt that the taxes should have been paid to the government, the court here was simply applying its own personal notion of public policy. As said in *Stephens v. Southern Pacific Co.*, 109 Cal. 86, 89 "* * * public policy is an unruly horse, astride of which you are carried into unknown and uncertain paths * * *". And other courts have said that a judge does not have "any jurisdiction to bring into the discussion his own views of what he may consider an expedient thing in his own peculiar view of public policy."²⁵

And in another context Mr. Justice Holmes in *Southern Pacific Co. v. Jensen*, 244 U.S. 205 at 220, commented that "there is no gratuity" about granting relief by a court of equity. "If the claim is enforced or recognized it is because the claim is a right * * *"

We submit that the trial court's sense of outrage that the tax authorities permitted the tax deductions was a false element in this case.

The District Court Did Not Apply Its Own Theory Consistently.

The District Court's theory was that it should "leave the parties where they are" (276). But its decision fails to do even that.

As we have seen (p. 24, *supra*), in August 1947 a stipulation of the parties and a pre-trial order of the court provided that for

hip. Over a period of years he purchased and sold cotton seed and other products at various landings without plaintiff's knowledge by using its name, money, credit and employees. In a suit by plaintiff for an accounting of profits, defendant set up the defenses that the plaintiff was not qualified to do business in Tennessee and was doing business in violation of the law, and that the transactions would have been ultra vires the plaintiff's corporate powers. In granting relief to the plaintiff the court said that no cases could be found to justify denying relief, and "it would be a reproach to the law if they could." It further said:

"There is more than one phase to sound public policy. One of these that ought to be paramount is that courts should close their ears when dishonest men attempt to rest on rules of law in an effort to shield them from the consequences of their misdeeds." (p. 951.)

²⁵Quoted in *In re Rabn's Estate*, 291 S.W. 120, 124 (Mo.) which reversed a lower court and contains a comprehensive review of the subject of public policy.

the purposes of this case \$3,385,290 should be deemed to have been paid by the Treasury to plaintiff, as a partial refund of 1942 taxes, and placed in the custody of the court to await judgment.

On the District Court's theory, the decree should have been framed so as to give effect to the mandate of this pre-trial order that plaintiff have possession of the \$3,385,290.²⁶

There is, moreover, an estoppel. Although the court below finally denied relief to plaintiff on the view that the tax settlement was "phony", it knew of that settlement, reviewed it, and made its pre-trial order about it, all before it was final and binding. Under the settlement the claim for refund was not withdrawn; it was merely rejected by the Treasury on August 26, 1947. Either the Treasury or the taxpayer could have ignored the settlement, the Treasury by imposing a deficiency assessment, the plaintiff by suing for a refund. (*Botany Worsted Mills v. United States*, 278 U.S. 282) The statute of limitations did not run against a suit by plaintiff until two years after rejection of the claim (I.R.C., Sec. 3772, subd. 2). That was just eleven days before the court below rendered its opinion. Had plaintiff not been lulled by the stipulation and the pre-trial order, it could have prevented the running of the statute.

B. PLAINTIFF IS NOT SEEKING TO GO BEHIND THE REORGANIZATION PLAN.

The second ground of the trial court's decision was its belief that plaintiff was not really seeking to share in the tax savings but was "circuitously" trying to obtain "something in the nature of equity or value" for its former ownership of the defendant and that a judgment for plaintiff would in effect go behind the reorganization plan and thereby "modify the administrative and judicial judgments in the reorganization proceeding" and be inconsistent with the "philosophy underlying Section 77 of the

²⁶After the District Court announced its decision, this aspect of the case was called to its attention by proposed findings of fact and conclusion of law (277-278) and by argument on the settlement of findings (439 et seq.).

Bankruptcy Act" which was designed for "resuscitating" "sick and ailing railroads" (272-273).

This reasoning, we submit, simply has no substance.

Plaintiff's claim is not remotely in derogation of the plan of reorganization. And in asking that the benefit of the tax savings be adjudged to belong to it, plaintiff does not at all seek to undo the plan but accepts its consequences in full. The full and utmost consummation of the plan *is not the end, but only the threshold, of this case.*

The tax savings arose *after* the plan was fully consummated. And it was the *fulfillment* of the plan—the very fact of its full and complete consummation—that created the factual situation which made the *later* tax savings possible. The plan was drastic. It wiped out the entire stock ownership of the old stockholder. Of this deprivation no complaint is made in the present suit and no relief against it is here sought. But the consummation of the plan, having stripped the plaintiff of that ownership, left plaintiff with something in its place—a huge loss and a right to utilize it for tax purposes.

It was then that defendant went beyond the plan and seized what plaintiff had left—its loss and right—to fatten its surplus by an additional \$17,000,000.

It was no part of the plan that this be done. Not only were the claim for refund and the 1944 returns filed after the defendant was out of reorganization, but the plan could not have commanded any such consequence even had it purported to do so. (See discussion at p. 52, *supra*, and *Callaway v. Benton*, 336 U.S. 132.)

The tax savings here involved had no bearing on the type of reorganization. They were unexpected—in the words of defendant's counsel below, "fortuitous." Indeed, the amendment to the Revenue Act which for the first time permitted the use of the stock loss to offset ordinary income and thus made possible the saving here was not enacted until October 1942 (Revenue Act of 1942, Sec. 123(a)).

The plan fully contemplated that the reorganized defendant company should pay its income taxes. It explicitly stated (233 I.C.C. at 455) that

"Notwithstanding any other provisions of this modified order, the reorganized company shall assume the liability for, and shall pay in full in due course, any and all taxes due to the United States from the debtor or the debtor's trustees for any taxable period prior to the date of the confirmation of the plan * * *"

The "revesting order" of November 27, 1944 (see p. 26, supra), by which the properties were restored to defendant and freed of bankruptcy administration, provided in paragraph 9 that defendant must

"assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945 * * *." (36 at 49.)

In consideration of the transfer to it by the trustees of all assets in their hands, the defendant executed an "Agreement of Assumption" on December 14, 1944, effective December 29, 1944, in the form authorized by the revesting order (1711 P 15). Thereby defendant specifically agreed to

"assume the liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945 * * *." (1716)

The defendant thus assumed the liability to pay the federal taxes. And it proceeded to make provision to do so. It did pay the taxes for 1942, it made monthly accruals to pay them for 1943 and 1944, and it set aside reserves of \$10,100,000 for that purpose (see p. 27, supra). As late as August 1944, the trustees reported to the bankruptcy court that, after the deduction of the \$7,100,000 reserve fund for 1943 taxes, the 1943 earnings were so large as to leave nearly \$9,000,000 available for dividends on the common stock, in addition to over \$11,500,000 required to carry out the provisions of the plan (2179 at 2188 D23 A).

This tax liability, which it was bound by the plan to pay and for which it had made cash provision, it later discharged,—not with the cash which it had set aside and which it still had available for the purpose and which it yet has but by the use of plaintiff's tax credits, which the Treasury accepted in August 1947.

We do not contend that the provisions of the Plan and Revesting Order quoted above, by which defendant was required to pay federal taxes, created the duty to pay anything to plaintiff. We refer to these provisions for a different reason: As they show, the Plan contemplated that defendant should pay its taxes and did not contemplate that it should retain the moneys required to discharge its tax liabilities. Those moneys would have been paid into the United States Treasury were it not for the subsequent appropriation by the trustees and the defendant of the plaintiff's credits—a result not even faintly imagined by the authors of the Plan or by the court which approved it.

Plaintiff's rights are based on principles of equity and quasi-contract, which became operative by reason of that subsequent appropriation and use. The trustees, being officers of a court, were particularly bound by those principles, for courts compel their officers to account, under principles of unjust enrichment, for benefits received even in circumstances where a less stringent standard of accountability might be applicable to the acts of private parties. *Glenn on Liquidation*, p. 833; *Carpenter v. Southworth*, 165 Fed. 428; *Gillig v. Grant*, 49 N.Y.S. 78, 81; *Standard Oil Co. v. Hawkins*, 74 Fed. 395, cited in *In re Berry*, 147 Fed. 208, 211 (2 Cir.).

The purpose of any bankruptcy proceeding is to discharge or scale down debts existing on and prior to the onset of the bankruptcy, not to discharge obligations arising during the bankruptcy from the operations of the court's officers. The full satisfaction of obligations arising from their acts is always protected. Here the onset of the bankruptcy was 1935, and the effective date of the plan of reorganization was January 1, 1939 (233 I.C.C. 412). The plan required, in paragraph Q, that

"current liabilities and obligations incurred by the trustees of the properties of the debtor during the reorganization proceedings * * * shall be paid in cash or assumed by the reorganized company * * *." (233 I.C.C. at 452)

The defendant did assume the obligations arising from the trustees' conduct of the business. In addition to assuming the liability to pay taxes, as noted at page 90 above, it agreed by paragraph 2 of the Assumption Agreement to

"assume any and all outstanding current liabilities and obligations incurred by said Trustees and * * * generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944." (1713)

Here the plan of reorganization had been prepared, approved by the court and affirmed by the Supreme Court, before the notion of saving taxes by use of plaintiff's loss was ever conceived. Although the notion was conceived later in 1943, it remained a "mere speculation of a possibility" by tax counsel until January 1944, when defendant first decided to make use of plaintiff's loss (see p. 17, *supra*). In the meanwhile the plan was approved by the creditors and confirmed by the bankruptcy court, in October 1943, and thus had already become effective to fix the rights and legitimate expectations of the defendant, its creditors and security holders.

Defendant emerged from the reorganization with the just obligation to pay its taxes and with more than ample funds to do so over and above any assets needed for the purposes of the plan. Enjoying all the benefits of the drastic features of the plan, the defendant Company, its new stockholders, and those investing in its securities, as well as the court, all expected it to pay its taxes. The statements issued by defendant to the public disclosed the contingent tax liability and the existence of \$10,100,000 of

reserves in government bonds set aside to meet it. No one supposed—no one would have had a right to suppose—that the defendant would escape this liability by appropriating what belonged to another.

If plaintiff is denied recovery in this case, the new owners of defendant will not only have taken ownership of the company from plaintiff (as the plan contemplated), thereby inflicting a \$75,000,000 loss, but they will also have taken from plaintiff, now an economic stranger already impoverished for defendant's benefit, plaintiff's tax credits resulting from that loss to enrich their position by an additional \$17,000,000, something never contemplated by the plan.

The trial court argues that, since a judgment would be paid out of earnings,²⁷ plaintiff is seeking to share in defendant's earnings (273) and that the Supreme Court's affirmance of the reorganization plan denied to plaintiff that right by divesting it of stock ownership.

Suppose that defendant had discharged its tax liabilities with cash taken from plaintiff. Or suppose that the rolling stock used by defendant Operating Company had been owned by plaintiff and leased to defendant, and defendant seized it outright. A plan of reorganization holding, as this plan did, that plaintiff's stock ownership was worthless would cut off plaintiff's right as stockholder, but it would not transfer to defendant the rolling stock, and it could not if it would (*Callaway v. Benton*, 336 U.S. 32; *Benton v. Callaway*, 165 F.2d 877, 882.²⁸) If, then, the defendant took the rolling stock, would it be exonerated from duty to pay for it? Forsooth, it could be said that if the defendant repaid the cash taken to pay its taxes or if it paid for the rolling stock, it would do so out of its "earnings." An argument that, if

²⁷ Apparently the court had in mind that the reserves were set aside from earnings.

²⁸ "A solvent corporation, which has appeared specially as creditor and assignor in a reorganization proceeding, cannot be constitutionally compelled against its will to convey to the debtor a larger and better title than was wanted in the lease."

plaintiff received a judgment for its cash or for the value of its rolling stock, it would be "circuitously" sharing in the earnings despite denial of that right by the Supreme Court would be a mere play on words. So it is here.

Nor can defendant's appropriation of plaintiff's rights be justified by the "philosophy" of Section 77 of the Bankruptcy Act, or by the view, as suggested in the trial court's opinion, that the purpose of the plan of reorganization to resuscitate the railroad will somehow be impaired by a judgment for plaintiff. That suggestion lacks justification in law as well as substance in fact. It could be said, in the example given above, that the rolling stock was necessary to resuscitate defendant. Yet it would not for that reason be exonerated from the duty to pay for it. With equal justice and reason defendant could forfeit the interests of the banks that now own title to the new Zephyr trains. This too, by relieving defendant of the duty to pay its just obligations, would no doubt better assure its stability and success. It would also be unjust. But it would be no more unjust than denial of relief to plaintiff here.

The plan did not contemplate that the reorganized defendants would emerge from bankruptcy with any surplus at all. But due to huge wartime profits it emerged with an unappropriated earned surplus of nearly \$30,000,000 (see p. 28, *supra*). The capital structure fixed by the plan was devised by the Interstate Commerce Commission so that the reorganized Company would be able to pay a dividend of \$3.00 per share per annum out of the income it could reasonably expect to earn. But in 1943 the company earned enough to pay \$27.99 per share of common stock, after setting aside the \$7,100,000 tax reserve, or \$50.24 before setting aside the reserve, and in 1942 it earned \$20.28 per share. (2179 and 2189, 2190 D 23 A, par. 11f and 12)

During the trusteeship \$30,000,000 of operating revenues were used for additions and betterments, and another \$6,000,000 of operating revenues were used to replace old equipment (see p. 28, *supra*). After all this, the remaining income from the effective date of this plan until December 31, 1943 was sufficient

to meet all bond interest and to make all payments into the capital fund and sinking fund required by the plan, and still leave \$20,658,938 (see p. 28, *supra*).

A judgment for plaintiff, which equity requires, will take from defendant nothing that it would have had if it had filed separate income tax returns and paid its taxes in cash, as the court below believes it should have done.

The real "paradox" in this case is the astounding fact that the capital stock of a subsidiary, decreed to have become and to be worthless in 1943, actually earned in the period January 1, 1942 to April 30, 1944, net income taxable on a separate basis in an amount in excess of \$21,000,000.

This Court could not agree that the stock was worthless (*In Re Western Pac. R. Co.*, 124 F.2d 136 (9 Cir.)). It was overruled by the Supreme Court. But that fact, while rendering unassailable the judicial divestiture of plaintiff's ownership of defendant, does not render the defendant immune from the duty to account for the value of other rights of the plaintiff which it seized after the consummation of the plan of reorganization—rights which were not in existence until after the plan was consummated—to the further enrichment of defendant and its new owners in the sum of \$17,000,000.

CONCLUSION

It is submitted that the judgment should be reversed. And since all the facts are before the Court, it is further submitted that the District Court be directed to enter judgment for plaintiff for the sum of \$17,201,739, to be paid to appellant Alexis I. duP. Bayard, Receiver, for ultimate distribution to the stockholders of plaintiff Corporation.

Dated: San Francisco, September 13, 1950.

Respectfully submitted,

HERMAN PHLEGER,
 MAURICE E. HARRISON,
 MOSES LASKY,
 BROBECK, PHLEGER & HARRISON,
 111 Sutter Street, San Francisco 4, Calif.,
 FRANK C. NICODEMUS, JR.,
 44 Wall Street, New York 5, N. Y.,
 A. PERRY OSBORN,
 20 Exchange Place, New York 5, N. Y.,
 NORRIS DARRELL,
 48 Wall Street, New York 5, N. Y.,
 MAHLON DICKERSON,
 120 Broadway, New York 5, N. Y.,
 LEROY R. GOODRICH,
 Bank of America Bldg., Oakland 12, Calif.
*Attorneys for Appellant,
 The Western Pacific Railroad
 Corporation.*

HERMAN PHLEGER,
 MAURICE E. HARRISON,
 MOSES LASKY,
 BROBECK, PHLEGER & HARRISON,
 111 Sutter Street, San Francisco 4, Calif.
*Attorneys for Appellant,
 Alexis I. duP. Bayard.
 Receiver.*

(Appendices follow)

APPENDIX ONE

In the Report of the Senate Finance Committee (70th Congress, 1st Session, Senate Report 960), quoted in *J. D. & A. B. Spreckels Co. v. Commissioner*, 41 B.T.A. 370, the following appears (p. 8):

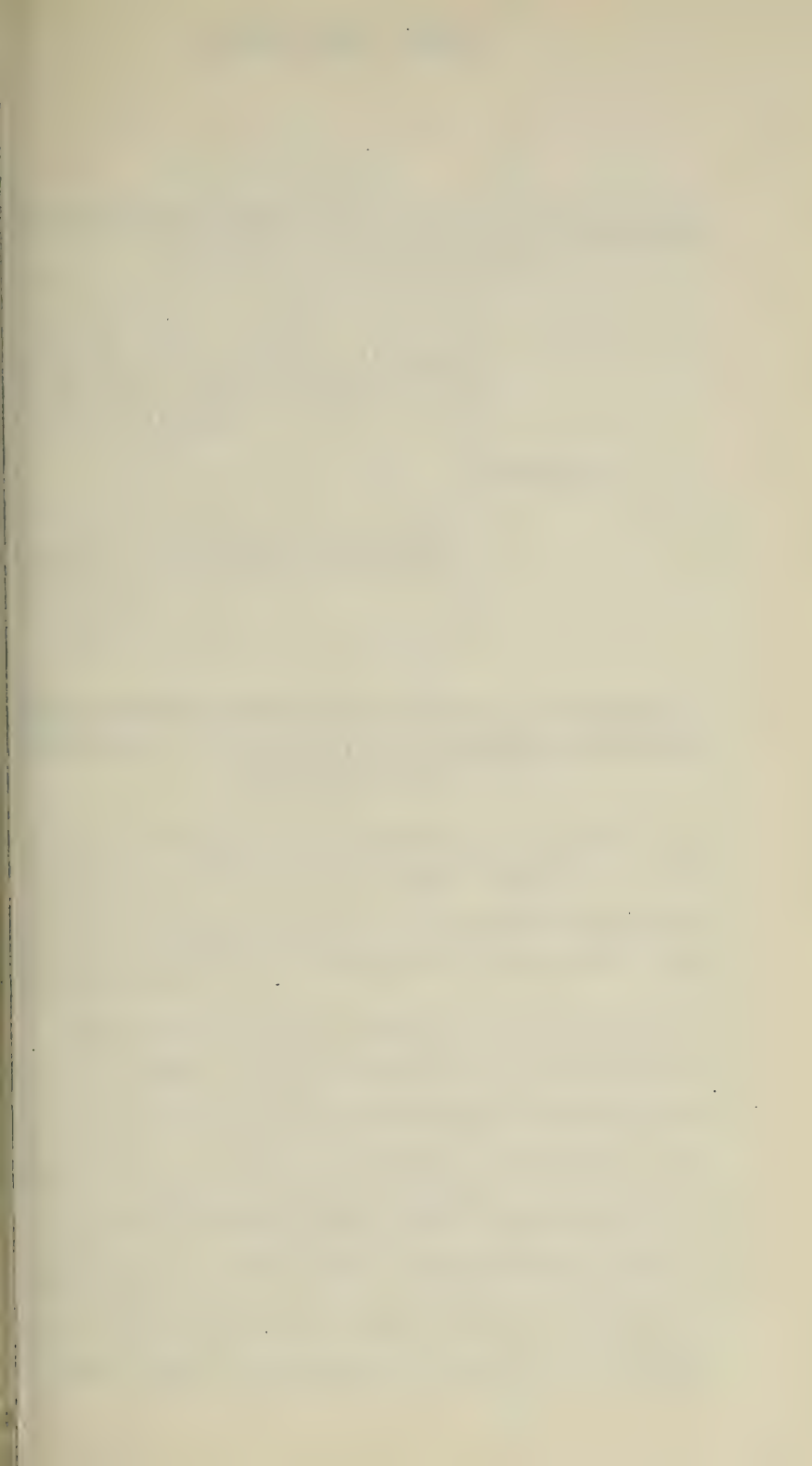
"* * * The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. Unless the affiliated group as a whole in the conduct of its business enterprise shows net profits, the individuals conducting the business have realized no gain. The failure to recognize the entire business enterprise means drawing technical legal distinctions, as contrasted with the recognition of actual facts. The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies. It would be just as unreasonable to demand that an individual engaged in two or more businesses treat each business separately for tax purposes." (374)

Vol. 69, Congressional Record, p. 653, contains the following discussion:

"Mr. Tilson. * * * Let us remember that the provisions of the bill are applicable only where corporations are, in effect, but one corporation, 95 per cent ownership being required. In most cases there is an ownership of 100 per cent. The interests are the same.

"The ability to pay must be governed by the net income of the entire group. Computing the income of each separate corporation is but the basing of an income tax upon paper profits. Our income tax law should be based as nearly as possible upon income actually realized.

"Group organization of corporations, all owned ultimately by the same stockholders, has been developed by modern business for perfectly legitimate reasons, among them being separate accounting for the various parts of an enterprise and the desirability, and frequently the necessity, of creating an independent corporation for the purpose of carrying on a particular part of the business, both at home and abroad. The mere fact that by a legal fiction these are separate entities should not obscure the fact that they are in reality one and the same business, owned by the same individuals, and run as a unit. To refuse to recognize this fact and to compel for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report for tax purposes the net result of its sales department, the net profit or loss on its manufacturing activities, the net profit or loss on its investments, or the net profit or loss on each and every one of its agencies. Such a requirement would be so absurd as to appear on its face ridiculous, and it is only necessary to state the case of a single corporation to demonstrate its absurdity. It is no more absurd, however, when applied to the different departments of a single corporation than it is when applied to the subsidiary corporation of a single unit. For instance, if a single corporation has a manufacturing department and a sales department, and we regard it as absurd to separate them for tax-accounting purposes, it is equally absurd when dealing with two subsidiary corporations, one of which does the manufacturing and the other one of which does the selling, to claim that theoretically they are two separate entities, when as a matter of fact, they are both engaged in a common, inseparable enterprise."



aforesaid, including specifically three suits in which the Corporation is beneficially interested, now pending in the Courts of the United States as follows:

(1) A case in the District Court of the United States for the Northern District of California, Southern Division, herein referred to as the Accounting Action for an inter-party equitable accounting respecting federal tax savings of approximately \$17,500,000 resulting from the use of tax credits belonging to the Corporation in consolidated income and excess profits tax returns for the period January 1, 1942 to April 30, 1944, alleged to be wrongfully withheld from the Corporation by the Western Pacific Railroad Company, a corporation of the State of California.

(2) A case in the same Court to enforce payment of an indebtedness alleged to be due from Sacramento Northern Railway, a wholly-owned subsidiary of said Western Pacific Railroad Company.

(3) A case in the United States District Court for the Southern District of New York in which the Corporation has filed a third party complaint under Rule 14 of the Rules of Civil Procedure asking rescission of a certain transaction alleged to have been induced by fraud of the James Foundation of New York, Inc., one of the parties to said cause.

In addition to these three proceedings in which the Corporation is directly interested, it is indirectly interested in an Informer's Action commenced in the United States District Court for the Northern District of California, Southern Division, on February 24, 1950, in the name of the United States by S. Roberts under 31 U. S. C. A. Section 231 to 235 to recover—one-half for the United States and one-half for himself—double the amount of the tax savings involved in the equitable Accounting Action first above mentioned.

Your Receiver has given precedence to the equitable Accounting Action, and is a party of record therein. He has appealed from the judgment of the District Court in the Accounting Action but has taken no steps in respect to either of the two last mentioned suits in which the Corporation is directly interested. The Receiver is advised, however, that both suits as concerns the right of the Corporation to money judgments are meritorious.

2. Your Receiver reports that payment of claims of creditors and a return of any capital to stockholders of the Corporation is contingent on the successful prosecution of one or more of the several causes of action outlined above and in the absence of other than nominal cash assets, your Receiver, with the approval of this Court, has not complied with paragraphs (1), (2) and (3) of Rule 151 of the Court of Chancery, and has not filed an inventory of the receivership estate together with an appraisal thereof, a list of the debtors and creditors of the Corporation or a list of the stockholders of said Corporation. It is proposed by your Receiver to seek the approval of this Honorable Court to extensions of time as to full compliance with Rule 151 of the Court of Chancery until recovery has been gained in one of the pending suits and a fund thereby created for payment of creditors and distribution to stockholders.

3. Your Receiver reports that the Corporation has approximately 4,600 stockholders, Preferred and Common, living throughout the United States, of which more than 1,000 reside in the State of California whose original investment appeared on the books of the Corporation in the sum of \$125,000,000, of which \$75,000,000 was invested in voting stock of the Western Pacific Railroad Company. It was organized originally to acquire the stock of Western Pacific Railroad Company and voting stock in the Denver & Rio Grande Western Railroad Company. A half interest

sions in the law also eliminated the tax paid in 1942, for which a refund claim was filed March 9, 1945, as well as the tax for the first three months of 1944, for which returns were filed June 15, 1945.

There was always a substantial question whether consolidated returns were admissible for the period subsequent to October 11, 1943, when economic unity between the Corporation and its subsidiary, The Western Pacific Railroad Company had ceased: a question serious enough to justify the settlement under which the Government retained, and the Corporation relinquished its refund claim for, the \$4,144,828 paid for 1942. The entire consolidated group being relieved of all tax liability by reason of the use of the Corporation's deductible loss, the reorganized Railroad Company, the principal defendant in the Accounting Action, was left in possession of \$17,201,739 as the amount saved by resorting to consolidated returns instead of separate returns and under the finding of Judge Goodman this is the fund involved in the Accounting Action.

The question whether this fund belongs in equity and good conscience to the Corporation or to the defendant Railroad Company is made neither more nor less difficult of true solution by the fact that the amount is greater than the amounts with which Courts are ordinarily called upon to deal; it is in fact appreciably less than the face of the judgment with which this Court is familiar, \$22,104,515.92 rendered by District Judge Welsh in *Overfield v. Pennroad Corporation*, and not greatly in excess of the amount, \$15,000,000 finally paid in the litigated settlement of that case approved by this Chancery Court and on appeal by the Supreme Court of Delaware in *Perrine, et al. v. Pennroad Corporation, et al.*, 47 Atl. 2nd, 479.

To determine judicially the validity of one and the invalidity of the other of the conflicting claims to the fund

asserted by the Corporation and by its subsidiary, the Western Pacific Railroad Company, requires knowledge of the history of, and an understanding of the reasons for, the provisions of the Internal Revenue Code authorizing consolidated returns.

Consolidated returns were first introduced into the federal Income Tax Law by the Commissioner of Internal Revenue by a Regulation under the Revenue Act of 1917. This Regulation was broadened and given express sanction by Section 240 of the Revenue Act of 1918 being then made mandatorily applicable both to income tax returns and to excess profits tax returns; and this continued to be the law until 1921 when the filing of consolidated returns was left optional. There was, however, a gradual transition from the original concept of a duty to file consolidated returns resting upon the taxpayer to the ultimate notion now prevailing that the filing of federal tax returns on a consolidated basis is a privilege extended to the parent of a multiple incorporated enterprise for which there should be paid a premium. Except in the special case of railroad corporations where multiple incorporation was ordinarily an unavoidable requirement of state laws no provision for consolidated returns is to be found in the federal tax laws between 1934 and 1940 when the privilege was restored as to income tax returns. In 1942 the law was again broadened, having been extended to excess profits returns by the Revenue Act of 1942—subject, however, to the payment for the privilege of an additional tax increased from $\frac{3}{4}$ of 1% to 2%.

In the same year there was introduced into the Internal Revenue Code the new Section 23 (g) (4) providing that stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset so that a loss resulting from the worthlessness of such stock acquired the character of an

operating loss credit deductible in the determination of taxable income.

Thus, continuously over a period of more than twenty-five years which included the economies of two World Wars there has been in the Internal Revenue Code, although for a part of the time only for railroad corporations, an authority for the filing of consolidated returns when there was the intercorporate unity inhering in 95% stock ownership; and in that long period the reason for the legislation showing the underlying intent of Congress has been so frequently reiterated that it is now crystallized in the text of the Treasury Regulation 104 which states:

“Consolidated returns are based upon the principle of levying the tax according to the true net income of a single enterprise, even though the business is operated through more than one corporation.”

Hence, whenever there exists the requisite stock ownership which has never been less than the present 95% minimum (5% less than all so as to permit beneficial ownership of directors' qualifying shares) the members of such affiliated group of corporations are accorded the privilege of pooling their incomes and pooling their tax credits and of paying federal taxes upon the excess, if any, of the pooled income over the pooled tax credits at the then current tax rate plus the additional 2% exaction for the privilege of resorting to the consolidated basis of accounting. If there is no such excess there is no tax and it was the clear intent of Congress that there should be none. Total Congressional forbearance came into play whenever the combined tax credits of the combined group exceeded the gains of the income producing members.

The tax credits which determine the existence or non-existence of tax liability differ in character and take a

variety of forms. In the years to which this controversy relates they included various specific exemptions, bad debts, amortizations, foreign and state taxes, unused operating losses and excess profits credits carried forward from prior years; and under Section 23 (g) (4) a current loss with carry-over and carry-back application resulting from the worthlessness of the corporate stock of any affiliate.

It would be inconsistent with the scheme and technique of consolidated returns ever to divorce the tax benefits from the unity of ownership which gives rise to them or to assume that Congress intended any benefit to any interest or tax paying entity other than the common parent corporation. This is recognized by the Securities Exchange Commission in exempting from the restraints upon inter-corporate transactions between utility corporations subject to the Utility Holding Company Act of 1933 those covered by its Rule U-45 (b) (6), which specifies:

“A loan or extension of credit or an agreement of indemnity arising out of a consolidated tax return filed by a holding company (or other parent company) and its subsidiaries: *provided*, that the top company in the group assumes primary responsibility for the payment of any tax liability involved *subject to the right of contribution* (italics supplied) from the several members of the group in an amount not exceeding as to any company that percentage of the sum of the normal tax, surtax and excess profits tax on a consolidated basis which the sum of the normal tax, surtax and excess profits tax of such company if paid on a separate return basis is of the aggregate amount of normal surtax and excess profits taxes of the individual companies based upon separate returns.”

It is not questioned by the Western Pacific Railroad Company, nor by the Commissioner of Internal Revenue

and indeed is apparently not questioned by District Judge Goodman that during the full period January 1, 1942 to October 11, 1943 the Corporation, as the common parent corporation, was the owner or was in a connected chain of ownership of at least 95% of all classes of stock of all of the other defendants or that the Corporation and the parties defendant in the Accounting Action were during all of that period properly affiliated within the letter of Section 141 of the Internal Revenue Code and Section 104 of the Treasury Regulations under which the consolidated returns for those periods were filed. Nor is it asserted that any requirement of subdivision (b) defining affiliation was not fully met.

The fact that during those periods the Corporation's principal subsidiary, the Western Pacific Railroad Company, was in trusteeship under Section 77 of the Bankruptcy Act is not of consequence as affecting or impairing its right as subsidiary to join with its common parent corporation and other affiliates in filing consolidated returns. Its right so to join and to be included, notwithstanding bankruptcy, is expressly recognized and provided for by Section 52 of the Internal Revenue Code and by Subdivision (c) of Treasury Regulation 104, Section 23.15. In passing it may be noted and perhaps emphasized that the last mentioned subdivision imposes an important limitation similar to that embodied in SEC Rule U-45 (b) (6) upon the accounting liability of an affiliate which is in bankruptcy. The liability of such an affiliate under a consolidated return is limited to what it would be if it had filed a separate return.

In the opinion of your Receiver, Congress intended—and clearly expressed its intention—that the Corporation's loss under the circumstances here disclosed might properly be used as *currency* to discharge, *subject to the right of equitable contribution*, the tax liabilities of the Corporation

and all of its statutory affiliates; and such was the expert judgment of the Commissioner of Internal Revenue. But, if the Commissioner of Internal Revenue erred in attributing such an intent to Congress it is difficult to understand what equitable principle permits Judge Goodman to convert the Commissioner's error into what he recognizes to be an "amazing and undeserved" windfall for the reorganized Western Pacific Railroad Company.

To state the Receiver's position concretely and in technical language: in an Accounting Action in equity between the Corporation and its affiliates in the period January 1, 1942 to October 11, 1943, for the value of a tax credit belonging to the Corporation and accepted by the Commissioner of Internal Revenue as the equivalent of money in the discharge of an individual tax liability of its subsidiary, the Western Pacific Railroad Company, in the amount of \$17,201,739 the subsidiary Railroad Company is estopped to assert in resisting accountability to the owner of the tax credit that the Commissioner of Internal Revenue accepted valueless currency under a mistake of law.

If the Corporation as the common parent being in ample funds had discharged its subsidiary's individual tax liability of \$17,201,739 by the use of money there would be no question that the subsidiary would be accountable to it for the money so paid.

This is clear on principle and is established by authority.

The well considered case of *Bankers Trust Company v. Florida East Coast Car Ferry Company*, 92 F. 2d (5th Circuit) so holds. This case arose as the result of the filing of federal consolidated income tax returns under which a tax credit belonging to one affiliate was applied to discharge a tax liability of another affiliate. A federal Receiver appointed for the affiliate whose tax credit has been so used sued for an accounting from the affiliate whose

tax liability had been so discharged; and reimbursement was awarded.

On principle that case is an indistinguishable authority in support of the Corporation's position in the present case.

If it be argued that the case is distinguishable because the tax credit there used was a money credit whereas in the present case the tax credit was a deductible loss, a negative thing having no actual value, the answer is that under the Internal Revenue Code the Corporation's tax credits including its deductible stock loss are made the equivalent of money for the discharge of the tax liabilities of the defendant Railroad Company for which they were employed.

Why should the subsidiary Railroad Company be free from accountability to its parent because instead of using money something else was used which for that particular payment Congress had ordained should be the equivalent of money? Why should the subsidiary Railroad Company even be interested in what currency was used so long as its tax liability was fully and completely discharged by what was used?

The obvious answer to these questions is supplied by the *Shreveport Bank Cases: Commercial Nat. Bank in Shreveport v. Connolly et al.* (176 F. 2d, 1002) and prior cases cited in footnote I to the opinion of Circuit Judge Waller. To avoid unduly extending this opinion and report it will be sufficient here merely to state that these cases hold the defendant liable to account to the plaintiff for tax savings realized by it through the use of a tax credit belonging to the plaintiff which was "a negative concept" (again to quote Judge Goodman) and of no value to the plaintiff but was of value to the defendant in enabling it to effect a tax saving of \$190,000.

Ordinarily the action of all of the subsidiaries joining in consolidated returns is dictated by the common parent

corporation as the dominant stockholder and hence controversy is rare.

Where, as in the present case, there has been a subsequent change of proprietorship which deprives the common parent corporation of control of the action of the former subsidiary and of power to require to be done that which ought to be done to avert frustration of the intent of Congress, a court of equity may properly require through its traditional Action of Accounting that parties to a consolidated tax return make all inter-corporate adjustments and transfers necessary to give effect to the intent of Congress. The simple fact is that a sum of money with which Congress had a right to deal and which happens to be a very large sum of money is in the possession of a party to a consolidated tax return where Congress did not intend it to be. In this situation there can be no reasonable doubt of the power, and (the Receiver confidently asserts), of the duty of a court of equity, a tribunal constituted for the very purpose of dealing constructively and justly with unexpected and unusual situations, to require that the money be put where it equitably belongs and where Congress intended.

The Receiver finds no substance in Judge Goodman's implication that the Accounting Action based upon what was done administratively by the Trustees in accordance with Section 52 of the Internal Revenue Code is an attempt on the part of the Corporation to secure "an interest in the debtor" cut off by the reorganization decree. Actually the very web and woof of the Corporation's equity asserted in the Accounting Action is the Corporation's *loss* of all interest in its former subsidiary—an equity rooted in the very reorganization decree to which the Corporation gives full faith and credit but which Judge Goodman believes the Corporation is trying to circumvent.

Where the cardinal error in Judge Goodman's opinion lies is in his failure to recognize that the Corporation's Accounting Action has nothing to do with the reorganization decree but arises out of relationships created by and equities and accountabilities flowing from the filing of consolidated returns—all of these being obligations which the reorganization decree required the Reorganized Company to assume and discharge under the Assumption Agreement. The Assumption Agreement embraces "generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use and operation of the debtor's property by said trustees or their conduct of the debtor's business including liabilities and obligations hereafter arising up to midnight December 31, 1944."

The Receiver finds nothing unusual about this case except the large sum of money involved. To summarize events:—The tax law provided for consolidated returns and Section 23 (g)(4) permitted any affiliate (including of course the Corporation and parent) to set off a stock loss against operating profits, instead of capital gains as theretofore. The Interstate Commerce Commission held the Corporation's stock in its subsidiary valueless although at the time October 1943 the stock was currently earning large sums of money. The stock of the operating subsidiary became valueless in October 1943, when there was no longer any chance for the Corporation to obtain the economic benefits of ownership and control; and in the final tax settlement the Government obviously balanced off the sum it might have collected by litigation, taxes from October 11, 1943 through April 1944, by retaining the sum previously paid but for which the Corporation had filed a valid refund claim. The Trustees of the bankrupt affiliate were expressly permitted to join in the consolidated

returns and by doing so brought the bankrupt affiliate into the group and subjected it to group treatment and inter-company accountability and the reorganized Company succeeded to its accountability under the all-inclusive Assumption Agreement.

For all these reasons the Receiver is of the opinion that the Court of Appeals will protect the position of the Corporation.

7. In the event of recovery in the Accounting Action, your Receiver will request that the amount thereof be paid directly to him, so that it may be disbursed under the supervision of this Honorable Court to the stockholders of the Corporation, after payment of all proper creditor claims and charges of this receivership.

AND your Receiver will ever pray, etc.

Respectfully submitted,

ALEXIS I. DUP. BAYARD
Receiver of the Western Pacific
Railroad Corporation

THIS IS TO CERTIFY that the foregoing is a true and correct copy of a preliminary report filed this date by Alexis I. duP. Bayard, Receiver of The Western Pacific Railroad Corporation, in compliance with an order of the Vice Chancellor entered on April 19, 1950.

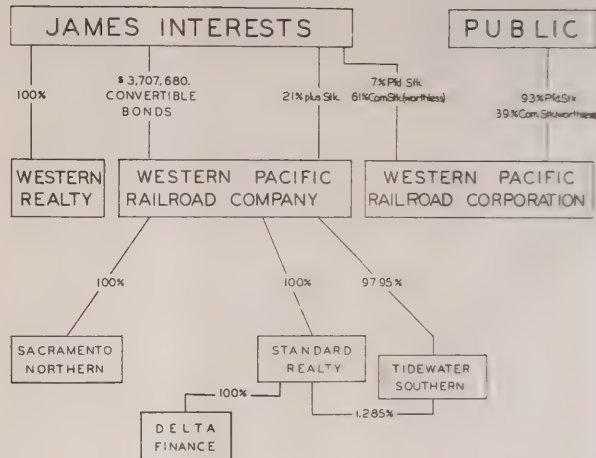
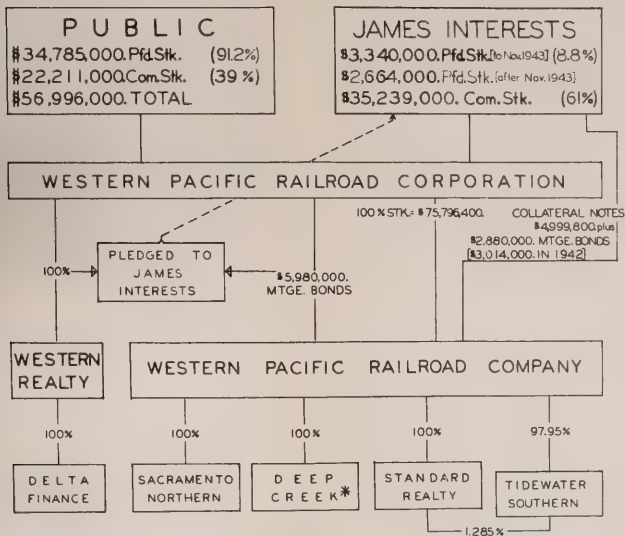
JOHN E. BABIARZ
Register in Chancery

Dated: May 15, 1950.

FROM BEFORE JANUARY 1, 1942 to MAY 1, 1944

INTERMEDIATE PERIOD DURING WHICH REORGANIZATION
PLAN WAS CONSUMMATED

AFTER REORGANIZATION



* dissolved 1944

P. Ex. 1 (As Corrected*)

* P. Ex. 1 inadvertently showed Delta Finance as dissolved in 1944, whereas it was Deep Creek that was dissolved.

POSITIONS HELD BY OFFICERS, DIRECTORS AND COUNSEL OF THE
W.P.R.R. CORPORATION WITH W.P.R.R. COMPANY AND TRUSTEES,
THEIR COMPENSATION AND SOURCE THEREOF DURING THE PERIOD
JUNE 1, 1943 TO OCT. 10, 1946.

C O R P O R A T I O N	C O M P A N Y a n d T R U S T E E S
WHITMAN, RANSOM; (ROBT. E. COULSON)	COULSON & GOETZ & JAMES K. POLK
TAX COUNSEL	TAX COUNSEL DIRECTOR (Coulson) from 12-28-44 COUNSEL for REORGANIZATION COM. MEMBER REORGANIZATION COM. (Coulson) to 3-28-46
	TOTAL OF \$149,325
SCHUMACHER	CH. EXECUTIVE COM. to 12-28-44 DIRECTOR to 12-28-44 TRUSTEE to 12-31-44
	PENSION from 5-1-45 \$15,000 PER YEAR
CURRY	From 5-1-45 \$3,000 PER YEAR
PRESIDENT TREASURER DIRECTOR	DIRECTOR & EXEC. COM. to 11-20-44 VICE PRESIDENT & ASST. SECT. & ASST. TREASURER to 4-30-45
	PENSION from 5-1-45 TO 5-1-45 \$11,700 PER YEAR
VALLOUCH	Secretary to Schumacher & Curry ASSISTANT SECRETARY 12-4-44 to 4-30-45
	From 5-1-45 \$3,000 PER YEAR
	Betw. \$2400 & \$2660. PER YEAR to 5-1-45
SHEEHAN	SWITCHBOARD OPERATOR & RECEPTIONIST to 5-1-45
	Between \$1980 & \$2344. PER YEAR
WINKEN	STENOGRAPHER to 5-1-45
	Betw. \$2880 & \$3212. PER YEAR
PIERCE & GREEN (NICODEMUS & CAMPBELL)	GENERAL COUNSEL DIRECTOR (Campbell) to 5-1-45
	TOTAL OF \$19,625.
OSBORNE	DIRECTOR & EXEC. COM. to 11-20-44
WOOD	
DIRECTOR	
HATTON	
DIRECTOR	

CLERK-DENVER RIO GRANDE WESTERN
R.R.CO IN OFFICE JOINTLY OCCUPIED
WITH WESTERN PACIFIC R.R.CO

P Ex. 2A.

சுற்றுலா துறைமுகம்
கடல் அமைச்சரவை
கடல் அமைச்சரவை
கடல் அமைச்சரவை
கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

கடல் அமைச்சரவை

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 12506

PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, Receiver,
Plaintiffs-Appellants,

vs.

PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDE-
SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN
COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and
FINANCE CO., LTD.,
Defendants-Appellees.

WITH H. METZGER, HENRY OFFERMAN and J. S. FARLEE & Co., Inc.,
Plaintiffs-Intervenors-Appellants,

vs.

PACIFIC RAILROAD COMPANY, SACRAMENTO NORTHERN RAILWAY, TIDE-
SOUTHERN RAILWAY, DEEP CREEK RAILROAD COMPANY, THE WESTERN
COMPANY, THE STANDARD REALTY AND DEVELOPMENT COMPANY and
FINANCE CO., LTD.,
Defendants-Appellees.

BRIEF FOR PLAINTIFFS-INTERVENORS-APPELLANTS

FILED
SEP 11 1950
WILLIAM E. HAUDEK,
JULIUS LEVY,
WEBSTER V. CLARK,
Rogers & Clark,
111 Sutter Building, San Francisco 4, Calif.

Pomerantz Levy Schreiber & Haudek,
295 Madison Avenue, New York 17, N. Y.

UL P. O'BRIEN,

CLERK

David Friedenrich,
Balfour Building, San Francisco 4, Calif.

Attorneys for Plaintiffs-Intervenors-Appellants.

TABLE OF CONTENTS

	PAGE
JURISDICTION	2
POSITION OF INTERVENORS.....	2
STATEMENT OF CASE.....	4
Plaintiff's \$75,000,000 stock loss.....	4
Plaintiff's tax credit and its use to save defend- ant's taxes	5
The anomalous nature of defendant's retention of the tax saving and the denial of any tax benefit to plaintiff	8
Duality of management.....	9
(a) Plaintiff's financial collapse and its depend- ence on defendant.....	10
(b) Plaintiff's stockholders (the James Interests)	11
(c) Plaintiff's officers	12
Michael J. Curry.....	12
John F. Wienken.....	13
Mary C. Valouch.....	13
(d) Plaintiff's directors	14
Thomas M. Schumacher.....	14
Catherine Sheehan	15
William W. Hatton.....	15
A. Perry Osborn.....	15
Willis D. Wood.....	15
H. Brua Campbell.....	16
(e) Plaintiff's lawyers	16
Pierce & Greer (Nicodemus and Campbell).....	16
Whitman Ransom Coulson and Goetz (Coul- son and Polk).....	17
5 Duality in action in the handling of the consoli- dated returns	18
(a) The returns for 1943.....	19

	PAGE
(b) The returns for 1944 and the refund claim for 1942	2
(c) The tax settlement with the Government.....	2
(d) Stipulation and pre-trial order concerning the effect of the tax settlement.....	2
(e) Defendant's \$10,100,000 reserve for this liti- gation	2
SPECIFICATION OF ERRORS RELIED UPON.....	2
SUMMARY OF ARGUMENT.....	2
POINT I—Defendant was obligated to deal fairly with plaintiff because of the duality of management.....	2
1. The duality rule	2
2. Scope of the duality rule.....	2
(a) Good faith	2
(b) Absence of secrecy	2
(c) Origin of duality.....	2
(d) Officers of the court.....	2
3. Application of the fiduciary rule to tax transac- tions	2
POINT II—Fairness required defendant to allow plain- tiff all or at least a substantial part of the tax sav- ings	2
A. The purpose of the tax law was to benefit plaintiff	
1. The purpose of § 23(g)(4) of the Internal Revenue Code	
2. The purpose and mechanics of consolidated returns	
B. Agreements for the fair allocation of tax savings among affiliated corporations are well supported by precedent	

	PAGE
Defendant's arguments disputing the propriety of a tax adjustment between plaintiff and defendant are unsound.....	49
1. The alleged illegality of a tax adjustment agreement	49
2. Absence of detriment to plaintiff.....	53
3. An attempted reductio ad absurdum of our position	57
ST III—The grounds upon which the District Court dismissed the action were erroneous.....	59
Plaintiff's alleged inability to recover because of the injustice of defendant's tax saving.....	60
1. The Government had no tax claim.....	60
2. The Government's tax claim has been validly and properly settled.....	62
3. Even if the tax settlement had been a wrong against the Government, it would not defeat plaintiff's rights	63
4. The District Court's pre-trial order, approving the parties' pre-trial stipulation, permits plaintiff to obtain at least the 1942 tax moneys	63
The alleged inconsistency of plaintiff's claim with defendant's reorganization plan.....	64
Plaintiff's alleged obligation to save defendant's taxes by filing consolidated returns.....	66
1. Plaintiff's alleged fiduciary duty to defendant	66
2. Plaintiff's alleged obligation under the bankruptcy laws	67
CONCLUSION	69

APPENDIX: Text of Statutes and Regulations Cited.....

Bankruptcy Act, § 7, 11 U. S. C. § 25.....

Internal Revenue Code.....

§ 23(g)(4)

§ 122(b)

§ 129

§ 141

Securities and Exchange Commission, Rule U-45.....

Treasury Regulation 104.....

§ 23.12

§ 23.15

§ 23.16(a)

TABLE OF CASES

Alameda Investment Co. v. McLaughlin, 28 F. 2d 81
(D. C., N. D. Cal., 1928), aff'd 33 F. 2d 120 (C. C. A.
9, 1929)Aluminum Goods Mfg. Co. v. Commissioner, 56 F. 2d
568 (C. C. A. 7, 1932), aff'd 287 U. S. 544.....Atlantic City Electric Co. v. Commissioner, 288 U. S.
152 (1933)Banco Kentucky Co.'s Receiver v. National Bank of
Kentucky's Receiver, 281 Ky. 784, 137 S. W. 2d 357
(1939)Bernheim v. Louisville Property Co., 185 Ky. 63, 214
S. W. 801 (1919).....3Blum v. Fleishhacker, 21 F. Supp. 527 (D. C., N. D.
Cal., 1937), mod. and aff'd 109 F. 2d 543, cert. den.
311 U. S. 665.....3

Brinkerhoff v. Bostwick, 88 N. Y. 52 (1882).....3

Burnet v. Aluminum Goods Mfg. Co., 287 U. S. 544
(1932)

	PAGE
elrob v. Barrett, 293 N. Y. 442, 57 N. E. 2d 825 (1944)	29, 31, 34
ties Service Co., Matter of (S. E. C. Holding Com- pany Act Release No. 5535, January 3, 1945, File No. 70-933)	45, 46, 59
mmercial National Bank in Shreveport v. Connolly, 176 F. 2d 1004 (C. A. 5, 1949), reh. den. 177 F. 2d 514	35, 55, 63
mmercial National Bank in Shreveport v. Parsons, 144 F. 2d 231 (C. C. A. 5, 1944), reh. den. 145 F. 2d 191, cert. den. 323 U. S. 796.....	35, 55, 63
nsolidated Electric & Gas Co., Matter of, 15 S. E. C. 61 (1943)	39, 45, 46
nsolidated Electric & Gas Co. (The Islands Gas & Electric Co.), Matter of, 13 S. E. C. 649 (1943).....	49
ke Power Co. v. Commissioner, 44 F. 2d 543 (C. C. A. 4, 1930), cert. den. 283 U. S. 903.....	40, 43, 58, 67
ker v. Western Pac. R. Corp., 318 U. S. 448 (1943).....	4
lishhacker v. Blum, 109 F. 2d 543 (C. C. A. 9, 1940), cert. den. 311 U. S. 665.....	54
ldes v. Anaconda Copper Mining Co., 254 U. S. 590 (1921)	28
ldes v. Anaconda Copper Mining Co., 245 Fed. 225 (C. C. A. 9, 1917), rev'd on other grounds, 254 U. S. 90	28
erge A. Fuller Co. v. Commissioner, 92 F. 2d 72 (C. C. A. 2, 1937).....	42, 60
oe Woolen Co. v. Utica G. & E. Co., 224 N. Y. 483, 21 N. E. 378 (1918).....	29
conda P. Corp. v. Petroleum Corp., 46 F. Supp. 23 (D. C., S. D. Cal., 1942).....	2
odell v. Verdugo Canon Water Co., 138 Cal. 308, 71 he. 354 (1903).....	29, 33
rigory v. Helvering, 273 U. S. 465 (1935).....	51

Handy & Harman v. Burnet, 284 U. S. 136 (1931).....	
Higgins v. Smith, 308 U. S. 473 (1940).....	
James Estate, In re, 86 N. Y. S. 2d 78 (Surr. Ct., 1948)	34,
Kavanaugh v. Kavanaugh Knitting Co., 226 N. Y. 185, 123 N. E. 148 (1919).....	
Keenan v. Eshleman, 23 Del. Ch. 234, 2 Atl. 2d 904 (S. Ct., 1938).....	
Kennedy v. Emerald Coal & Coke Co., 42 Atl. 2d 398 (S. Ct., Del., 1944).....	
Koral v. Savory, Inc., 276 N. Y. 215, 11 N. E. 2d 883 (1937)	
Leslie v. Commercial National Bank in Shreveport, 28 F. Supp. 927 (D. C., W. D. La., 1939).....	35,
Los Angeles Lumber Products Co., In re, 46 F. Supp. 77 (D. C., S. D. Cal., 1941).....	
Mahler v. Oishei (N. Y. Co. Index No. 28485, N. Y. Sup. Ct., Nov. 12, 1947), reviewed 61 Harvard L. Rev. 1058 (1948).....	
Mayflower Hotel Stockholders Protective Committee v. Mayflower Hotel Corp., 173 F. 2d 416 (App. D. C., 1949)	
Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545 (1928)	31
Ogden Corporation, Matter of (S. E. C. Holding Company Act Release No. 5904, July 23, 1945).....	
Overfield v. Pennroad Corp., 42 F. Supp. 586 (D. C., E. D. Pa., 1941), rev'd on other grounds, 146 F. 2d 889	31
Pepper v. Litton, 308 U. S. 295 (1939).....	
Potter v. Sanitary Co. of America, 22 Del. Ch. 110, 194 Atl. 87 (1937).....	

	PAGE
Reconstruction Finance Corp. v. Denver and R. G. W. R. Co., 328 U. S. 495 (1946).....	10
San Diego v. San Diego & L. A. R. Co., 44 Cal. 106 (1872)	29
Sheehan v. Erbe, 77 App. Div. 176, 79 N. Y. S. 43 (1st Dept., 1902)	37
Southern Pacific Co. v. Bogert, 250 U. S. 483 (1919).....	30, 66
Streckels Co. v. Commissioner, 41 B. T. A. 370 (1940)...	40
Tele. Ins. & Tr. Co. v. California Development Co., 171 Cal. 173, 152 Pac. 542 (1915).....	29, 30
Unity Buildings Corp. v. Commissioner, 40 B. T. A. 315 (1939)	42, 60
Uncle v. Universal Pictures Co., 76 F. Supp. 465 D. C., S. D. N. Y., 1948).....	35, 36, 56
United Public Utility Corporation, Matter of (S. E. C. Holding Company Act Release No. 6301, December 1, 1945)	49
United States v. Chemical Foundation, 272 U. S. 1 (1926)	63
United States v. Cleveland, P. & E. R. Co., 42 F. 2d 33 (C. C. A. 6, 1930).....	42
Western Pac. R. Co., In re, 124 F. 2d 136 (C. C. A. 9, 1941)	4

TABLE OF STATUTES AND REGULATIONS

Bankruptcy Act, § 7(b), 11 U. S. C., § 25(b).....	67,	PA
Internal Revenue Act of 1918, § 142(b).....		App
Internal Revenue Code:		
§ 23(g)(4)	5, 38, 39,	App
§ 122(b)		App
§ 129		App
§ 141	5	App
§ 141(a)	9	App
§ 141(b)		App
Public Utility Holding Company Act of 1935 (15 U. S. C. §§ 79 et seq.).....		App
Securities and Exchange Commission, Rule U-45(b)(6).....	32, 44, 47, 50	App
Treasury Regulation 104:		
§ 23.12(b)		App
§ 23.15		App
§ 23.15(d)	37	App
§ 23.16(a)		App
28 U. S. C. § 1291.....		
28 U. S. C. § 1332.....		
28 U. S. C. § 2107.....		

TABLE OF AUTHORITIES

	PAGE
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Wetlicher Cyc. Corp. (Perm. Ed., 1947), § 961, p. 433.....	33
Montgomery's Federal Taxes, Corporations and Partnerships (1946-47), 649-650	9
statement of Restitution (1937):	
§ 1, Comment e, pp. 14-15.....	54
§ 197, Comment c, pp. 809-810.....	54
Senate Finance Committee, Report, 70th Cong., 1st Sess., S. R. 960 (1938).....	40

CHRONOLOGY OF FACTS

Date

- 1916 Plaintiff acquires all of the stock of defendant \$75,000,000.
- 1925 The James Interests acquire control of plaintiff.
- 1935 Defendant goes into reorganization.
- 1940 The District Court approves defendant's reorganization plan.
- 1943
- Mar. 15 The Supreme Court affirms the approval of defendant's reorganization plan.
- June 1 Plaintiff's officers become full-time employees of defendant, paid solely by defendant.
- 1944
- Jan. Defendant decides to eliminate its taxes by using plaintiff's tax credit.
- Apr. 30 Plaintiff transfers its stock in defendant to defendant's reorganization committee.
- July 15 Plaintiff files consolidated tax returns for 1943.
- Dec. 29 Defendant emerges from reorganization.
- 1945
- Mar. 9 Plaintiff files the refund claim for 1942 taxes.
- Apr. 30 Defendant closes the New York office; plaintiff's office moves to the suite of Whitman, Ransom, Coulson & Gould.
- June 15 Plaintiff files consolidated tax returns for the first six months of 1944.
- 1946
- June 26 Curry signs plaintiff's power of attorney in favor of Plaintiff.
- June 27 Intervenor institute the New York stockholders' action.
- Oct. 10 Plaintiff institutes this action.
- 1947
- Feb. 11 Polk offers, in plaintiff's name, to settle the tax controversy with the Government.
- Apr. 2 Polk notifies plaintiff of this offer.
- Aug. 13 The Government accepts the settlement offer.

United States Court of Appeals

FOR THE NINTH CIRCUIT

WESTERN PACIFIC RAILROAD CORPORATION
and ALEXIS I. DUP. BAYARD, Receiver,
Plaintiffs-Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY,
SACRAMENTO NORTHERN RAILWAY, TIDE-
WATER SOUTHERN RAILWAY, DEEP CREEK
RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DE-
VELOPMENT COMPANY and DELTA FINANCE
CO., LTD.,

Defendants-Appellees.

No. 12506

CREDIT H. METZGER, HENRY OFFERMAN
and J. S. FARLEE & Co., INC.,
Plaintiffs-Intervenors-Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY,
SACRAMENTO NORTHERN RAILWAY, TIDE-
WATER SOUTHERN RAILWAY, DEEP CREEK
RAILROAD COMPANY, THE WESTERN REALTY
COMPANY, THE STANDARD REALTY AND DE-
VELOPMENT COMPANY and DELTA FINANCE
CO., LTD.,

Defendants-Appellees.

BRIEF FOR PLAINTIFFS-INTERVENORS- APPELLANTS

This is an appeal by plaintiffs-intervenors ("inter-
venors" hereinafter) from the final judgment herein of
the United States District Court for the Northern District
of California, Southern Division (Goodman, D. J.), dis-
missing the action after a trial without jury. A companion

appeal by plaintiff * is likewise before the Court. The District Court's opinion and findings (R. 258, 319) are reported 85 F. Supp. 868.

Jurisdiction

The District Court's jurisdiction is predicated on diversity of citizenship and presence of the jurisdictional amount (28 U. S. C. § 1332). The jurisdictional facts are alleged in the complaint (R. 6) and admitted in defendants' answer (R. 12, 117-8).**

The appellate jurisdiction of this Court rests on 28 U. S. C. § 1291. The final judgment below, as amended, was filed January 13, 1950 (R. 324-5). The notice of appeal was filed on February 8, 1950 (R. 327), within the time limited by 28 U. S. C. § 2107.

Position of Intervenors

In the light of the able and learned brief submitted by counsel for plaintiff, we would hesitate to burden the Court with an additional memorandum were it not for certain differences in presentation and analysis which we consider as important. The differences arise from the history of the litigation and the peculiar position of the intervenors.

* Plaintiff-appellant *Western Pacific Railroad Corporation* is here referred to as "plaintiff" or the "Corporation".

Defendant-appellee *Western Pacific Railroad Company* is here referred to as "defendant" or the "Company". With respect to the period from November 1935 to December 1944, the reference to "defendant" will include its reorganization trustees in whose hands during that time, were defendant's assets and affairs.

The other defendants-appellees are present or former subsidiaries of the defendant Company and have comparatively minor stakes in the litigation.

** The intervenors' citizenship (R. 124, 156, 158, 176) is immaterial to the jurisdiction; *Golconda P. Corp. v. Petroleum Co.*, 46 F. Supp. 23, 25 (D. C., S. D. Cal., 1942).

The intervenors own 25,465 shares of plaintiff's preferred stock (R. 1650-2), about 6.7% of all the preferred outstanding (R. 1717). In June, 1946—prior to this action—the intervenors instituted a stockholders' action in the federal District Court for Southern New York, in which the claim involved herein (in addition to other claims) was asserted for the first time (R. 337, 706-7, 124). The New York complaint alleged, in short, that plaintiff and defendant had interlocking managements; that plaintiff was controlled by defendant's agents; that these facts created a fiduciary relation between plaintiff and defendant, requiring defendant to deal fairly with plaintiff; and that defendant, in certain tax transactions with plaintiff, had breached its fiduciary duty to plaintiff by appropriating all benefits of the transactions to itself and allowing none to plaintiff.

After the legal sufficiency of the New York complaint had been sustained (R. 337), plaintiff's management and attorneys (named as defendants in New York) caused plaintiff to file its original complaint herein on October 1, 1946, complaining of the same tax transactions with defendant (R. 5).

Plaintiff, however, failed to allege the managerial interlock between the parties or the control of plaintiff by defendant's agents. Accordingly, we moved for leave to intervene herein on the ground that plaintiff's management inadequately represented the rights of plaintiff and its stockholders; and this motion was granted on April 7, 1947 (R. 122).

Our intervenors' complaint (R. 123) alleged the facts, admitted by plaintiff, establishing what we conceive to be an all-important fiduciary relation between plaintiff and defendant. Plaintiff at first denied these allegations and refused to submit to the intervenors to their proof * (R. 156); later on plaintiff adopted certain of our allegations, but not those re-

The intervenors accepted this invitation, as demonstrated by the extensive depositions (R. 275) which produced the evidence at the

ferring to its own personnel (R. 208); until finally plaintiff's present counsel, retained on the eve of trial, likewise proclaimed the existence of the fiduciary relation.

Nonetheless, substantial differences still exist between plaintiff and intervenors in the presentation and analysis of the factual basis and the legal effect of this fiduciary relation. We are therefore impelled to submit this separate brief in which, appearing on behalf of stockholders (not management), we can let the chips fall where they will.

Statement of Case

1. Plaintiff's \$75,000,000 stock loss.

In 1916 plaintiff, a holding company, acquired all stock of defendant, an operating railroad company (R. 493). Plaintiff's investment in defendant's stock was more than \$75,000,000 (R. 262).

In 1935 defendant went into bankruptcy reorganization (Bankruptcy Act, § 77) in the Court below, its property being placed in the hands of two court-appointed trustees (R. 494). In 1939 the Interstate Commerce Commission promulgated a plan of reorganization (233 I. C. C. 41) which declared that defendant's stock held by plaintiff was worthless and not entitled to share in the assets of reorganized Company (R. 259, 495). Under the plan secured creditors of defendant were to become its new owners and were to receive all of its stock, when issued.

This reorganization plan was approved by the District Court in 1940 (R. 259). Although reversed on appeal, *In re Western Pac. R. Co.*, 124 F. 2d 136 (C. C. A. 9, 1942), the plan was, on March 15, 1943, reinstated and affirmed by the Supreme Court and thus became final; *Eckman v. Western Pac. R. Corp.*, 318 U. S. 448 (1943). In due course the plan was confirmed on October 11, 1943 (R. 260); it was consummated on December 29, 1944 when the reorganization trustees returned the assets to defendant.

endant issued its new securities in accordance with the plan (R. 499, 2000).

The results of defendant's reorganization were shattering to plaintiff. Its principal asset, the \$75,000,000 investment in defendant's stock, was totally lost. The loss was irretrievable; for however prosperous defendant might become in the future, plaintiff had no part therein. From March 15, 1943—the date of the Supreme Court's affirmation of the reorganization plan—the economic unity between plaintiff and defendant was severed; plaintiff and defendant became and remained complete strangers to each other.

2. Plaintiff's tax credit and its use to save defendant's taxes.

Staggering as plaintiff's loss was, it presented one mitigating feature: The amount of the loss could be used as income and excess profits tax deduction. The right to this tax credit was created by Internal Revenue Code, §(g)(4),* enacted in 1942, which provided that losses resulting from the worthlessness of the stock of an affiliate were to be treated as operating losses (rather than as capital losses as theretofore).

But plaintiff was not allowed to derive any benefit from this tax credit. Instead, the entire benefit was reaped by defendant. This was accomplished through the mechanics of consolidated tax returns.

(a) Consolidated tax returns may be filed by an affiliated group of corporations headed by a common parent and inter-connected by at least 95% stock ownership (Internal Revenue Code, § 141). In such a consolidated return the affiliated group is treated, for tax purposes, as a single enterprise, so that the losses sustained by any one or more states are deducted from the profits realized by the other states. Only if the group as a whole realizes a net profit is a tax payable thereon.

*The text of the statutes and regulations cited is set forth in the appendix of this brief.

A consolidated return can be filed only by the parent corporation of the group; and it requires the consent of all affiliates. Treas. Reg. 104, § 23.12(b) and § 23.16(a).

(b) Plaintiff, as stated, owned all of defendant's stock. Although the Supreme Court's decision of March 15, 1944, had rendered the stock economically worthless, it was still legally valid because defendant's reorganization was not yet consummated. Plaintiff continued to own the stock until April 30, 1944, on which date plaintiff surrendered it to defendant's reorganization committee (R. 260). The legal stock ownership made it possible for plaintiff to file consolidated tax returns for itself and defendant, covering the year 1943 and the first four months of 1944 (see *infra*, pp. 42-43).

During this period defendant had realized very substantial profits from its war-time railroad operations. Ordinarily defendant would have had to pay a huge tax—more than \$17,000,000—on its profits (R. 262). But there was an alternative to the payment of this tax: If plaintiff filed consolidated tax returns, plaintiff's tax credit arising from its stock loss could be offset against defendant's profits and no tax would be payable. This possibility existed not only in the year 1943, in which plaintiff's stock loss had occurred; but plaintiff's tax credit could also be "carried back" to 1942 and "carried forward" to 1944 (Internal Revenue Code, § 122(b)).

(c) The opportunities offered by the tax laws were utilized. Under circumstances to be detailed below, defendant caused plaintiff to file consolidated returns for 1943 and the first four months of 1944.* These returns (Pl. Exs. 4-A, 4-B, 5-A, 5-B) claimed defendant's stock loss as a complete offset to defendant's earnings; hence they reported no tax as due; and defendant paid no tax for these periods (R. 266-7).

* For brevity, the returns for the first four months of 1944 are hereinafter referred to as the "1944 returns".

Nor was this all. Defendant had paid \$4,201,821.54 in taxes for 1942 (Pl. Ex. 6; R. 1654-6). But the carry-back of plaintiff's stock loss to 1942 would eliminate all of defendant's tax liability for that year. Accordingly, plaintiff filed a claim with the Government for the refund of these \$4,201,821.54 (Pl. Ex. 6; R. 1654).

Each of these documents—the consolidated returns and the refund claim—were filed after March 15, 1943, the date of the economic severance of plaintiff and defendant, namely:

- the 1943 returns on July 15, 1944;
 - the 1942 refund claim on March 9, 1945;
 - the 1944 returns on June 15, 1945.
- (Pl. Exs. 4-A, 4-B, 5-A, 5-B, 6.)

(d) The Government did at first dispute the propriety of deducting plaintiff's stock loss, principally on the ground that the loss had occurred in 1940 and was therefore inadmissible as a deduction against 1943 income (R. 267, 1423-5). Finally, however, in August 1947, the Government consented to a settlement; plaintiff agreed to the rejection of the refund claim for 1942, while the Government acquiesced in the 1943 and 1944 tax returns showing no tax due (R. 267-5, 262-3).

The Court below found that, but for the use of consolidated returns and the deduction of plaintiff's stock loss, defendant would have had to pay more than \$21,000,000 in taxes for the period 1942 to 1944 (R. 261-2, 265). As a result of the settlement, defendant paid only about \$1,000,000, so that it realized a net tax saving of more than \$17,000,000 (R. 266-7).

It is our contention that, in equity and fairness, at least a substantial part of this tax saving belonged to plaintiff and that defendant should be required to account therefor to plaintiff. We proceed to state, in brief outline, the circumstances supporting our position.

3. The anomalous nature of defendant's retention of the tax saving and the denial of any tax benefit to plaintiff.

(a) Normally the tax credit arising from a stock loss such as that sustained by plaintiff—redounds to the benefit of the party who suffered the loss. This is as it should be since the tax deduction is designed to mitigate the loss.

Normally, this reasonable result obtains also where parent corporation, by filing consolidated returns, deducts its loss from the earnings of a subsidiary. For the tax saving of the subsidiary redounds automatically—through the payment of dividends or through the increased value of the parent's equity in the subsidiary—to the benefit of the parent which, in an economic sense, owns the assets of the subsidiary. Again this accords with the purpose of the tax law which permits consolidated returns in order to give the parent, as the owner of the group, the benefit of all group losses, both its own and its subsidiaries'.

But this normal and intended result of the operation of the tax laws (more fully discussed *infra*, pp. 38 et seq.) completely failed in the case at bar. At the time the consolidated returns here were filed, plaintiff's stockholding in defendant had been declared worthless by the Supreme Court; the economic relationship between plaintiff and defendant had been severed; and plaintiff derived no benefit whatever from any tax savings flowing to defendant. The purpose of the tax laws was thus perverted: The prosperous defendant obtained a wholly gratuitous deduction for a loss which it had never suffered; while the intended automatic upstream flow of defendant's tax saving to its parent, the plaintiff, was prevented by the economic severance of the parties. Plaintiff's stock loss remained unalleviated by any tax advantage; while defendant obtained an undeserved and unmotivated tax windfall.

(b) Plaintiff nevertheless had the means to cause the tax benefits to go where, in justice and by the spirit of the tax law, they belonged, namely, to plaintiff. For plaintiff

d, as a matter of law, a free choice whether or not it could file consolidated returns (R. 1458).^{*} Before filing consolidated returns plaintiff's management could have made suitable arrangements with defendant concerning the ultimate disposition of the resulting tax savings—a type of arrangement both legal and by no means unusual (*infra*, p. 49 et seq.). If defendant was willing to do equity it is bound to agree that the tax benefits flowing from plaintiff's \$75,000,000 loss should belong to plaintiff in order to mitigate that loss. If defendant insisted on its pound of flesh, plaintiff could have at least made sure that it would receive an appropriate portion of the tax savings. Under the circumstances was defendant in a position to demand that all the tax savings be given to it and that plaintiff get nothing.

And yet this is precisely what was done. Although virtually all of the tax savings were, by the intent of the tax law and by every instinct of reason and equity, intended to mitigate plaintiff's loss; and although none of the savings could have been accomplished without plaintiff's filing consolidated returns and the use of plaintiff's tax credit; nevertheless plaintiff was not allowed to receive one cent. Defendant was permitted to retain for itself the entire \$75,000,000.

. Duality of management.

This complete and abject surrender of plaintiff's interest to defendant has a simple explanation: The allegiance of plaintiff's management to defendant. In short, during the critical period in which the consolidated returns were filed, plaintiff's officers were actually subordinate employees of defendant; a majority of plaintiff's board of directors were

^{*}Under Internal Revenue Code, § 141(a), the filing of consolidated returns is a "privilege" the exercise of which is optional. The fact that plaintiff had filed consolidated returns in earlier years, did not prevent it from filing separate returns for 1943 and 1944; 2 *Montgomery's Federal Taxes, Corporations and Partnerships* (1946-47), ¶ 650.

employees of defendant; plaintiff's lawyers were simultaneously lawyers for defendant. All compensation paid to these persons was paid solely by defendant, not one cent by plaintiff. These were the people who were charged with the responsibility of protecting plaintiff's interest in its relation to defendant.

The duality of allegiance of plaintiff's management forms an important basis of our claim; it created the fiduciary relation and defendant's duty to deal fairly with plaintiff. The facts must therefore be stated in somewhat more detail.

(a) *Plaintiff's financial collapse and its dependence on defendant.* The Supreme Court's affirmance of defendant's reorganization plan on March 15, 1943 left plaintiff an empty corporate shell. It had no assets; it had no income; it had no funds (Pl. Ex. 47; R. 573, 790). Its principal investment, the stock of defendant, was declared worthless. At the same time, its only other substantial asset, a one-half interest in the stock of the Denver Railroad, was eliminated by the latter's reorganization plan (R. 575).^{*} As one of plaintiff's directors put it, plaintiff had become a "corporation without assets", a mere "no entity" (R. 1130-1).

From the early days of their affiliation, plaintiff and defendant had maintained a joint office in New York, staffed by common employees (R. 643). On June 1, 1943, on the heels of the Supreme Court's decision, defendant assumed the whole expense of the New York office and took over plaintiff's officers as "full time employees" of defendant (Pl. Ex. 30, R. 527, 1738). The individuals thus taken over by defendant nevertheless remained the officers of plaintiff, but received their compensation solely from defendant, nothing from plaintiff (Pl. Ex. 23, R. 520, 1721; R.

^{*} The Denver's reorganization plan, approved by the I. C. (order of June 14, 1943 (254 I. C. C. 349, 385)), was subsequently affirmed by the Supreme Court, *Reconstruction Finance Corp. v. Denver and R. G. W. R. Co.*, 328 U. S. 495 (1946).

Ex. 27, R. 523, 1729-33). On April 30, 1945, at defendant's direction, the New York office was closed (R. 650) and plaintiff's officers and records were quartered at the offices of Whitman Ransom Coulson and Goetz, defendant's New York tax counsel (R. 651-2, 655).

Plaintiff's financial collapse, as will be seen, was the signal for its officers, directors and lawyers to desert the sinking ship and to climb on that of defendant. Even plaintiff's dominant stockholder, finding its economic stake in defendant much larger than that in plaintiff, likewise switched its allegiance to defendant.

(b) *Plaintiff's stockholders (the James Interests)*. In 1925, one Arthur Curtiss James, through his personal holding companies,* acquired 61% of plaintiff's common and 3% of its preferred stock (R. 501), constituting control. By 1943 plaintiff's common stock, ranging behind more than \$38,000,000 of preferred (R. 1717), had become completely worthless; and even the preferred stock was of trifling value.

But the James Interests also held large amounts of the secured obligations of defendant (R. 1718) which, under the reorganization plan, entitled them to 28% of the to-be-issued stock of defendant (Pl. Ex. 1).** It was therefore to the advantage of the James Interests to favor defendant, not plaintiff. Thus if the tax savings here involved accrued to defendant, the James interest therein was 28%; while it was only 8.8% if the tax savings went to plaintiff. The James Interests acted in accordance with their advantage: They abandoned plaintiff and cast their lot

* Arthur Curtiss James died in 1941 (R. 745). He, his estate, his personal holding companies (R. 503) and the James Foundation of New York, Inc. (R. 1011) are herein referred to as the "James Interests".

** Under the plan, the James Interests were entitled directly to 22% of the defendant's new voting stock (R. 975) and, in addition, to convertible bonds of defendant which the James Interests subsequently converted into voting stock of defendant (R. 1718; see 1725-8), giving them an aggregate of 28%.

with defendant. They decided to support defendant's reorganization plan (R. 618) which theretofore they had opposed (R. 536-7). They decided to withhold further advances to plaintiff (R. 575-6); the James representative on plaintiff's board retired (R. 1480); and at plaintiff's annual meetings the James stock was neither represented nor voted (Pl. Ex. 19, R. 503; Def. Ex. 54, R. 1630, 2053-2069). Plaintiff was thus deprived of that measure of protection and supervision which a vigilant controlling stockholder ordinarily would exercise over a corporation's management.

Plaintiff's 4700 public stockholders (R. 659), scattered throughout the country (R. 659), were forced into equal inactivity since plaintiff was too impoverished even to send out proxies or proxy statements for its annual meetings (Def. Ex. 54, R. 2053-2069). None of those meetings was therefore attended by a quorum (Pl. Ex. 19).

The protection of plaintiff's interests was thus left entirely to the integrity and vigilance of its officers and directors.

(c) *Plaintiff's officers.* During the period in which the consolidated tax returns and the refund claim were filed—1944 and 1945—plaintiff had only two officers: Its president Curry and its secretary Wienken, later replaced by Valouch (R. 1719).

Michael J. Curry was not only the president, treasurer and a director of plaintiff throughout the critical period (R. 1719, 1720) but, at the same time, also a vice-president, a director and a member of the executive committee of defendant (R. 719, 1724).^{*} Despite these titles, Curry considered himself merely a "figurehead" (R. 646-7). In actual position was, and had been since 1927, simply that chief clerk or office manager (R. 639); he was "merely

^{*} Curry resigned as defendant's vice-president on April 30, 1944 (R. 1724) and as defendant's director on November 20, 1944 (R. 719).

ning officer" (R. 641, 1450) and signed whatever documents Schumacher (defendant's chairman) or Elsey (defendant's president) told him to sign (R. 642). From June 1, 1943 Curry's entire compensation was paid by defendant (R. 1738); nothing whatever by plaintiff (R. 645). After the closing of the New York office on April 30, 1945, defendant arranged for Curry to move to the offices of Whitman Ransom Coulson and Goetz, defendant's tax counsel (R. 1287-8), and for them to pay him a \$3,000 annual "retainer", because Curry's services "as president of the old holding company" (i.e., plaintiff) were "essential" in connection with the pending tax questions which your company [i.e., defendant] has up with the Federal Government" (Pl. Ex. 32-A, R. 1744). Defendant agreed to reimburse Whitman Ransom for these retainer payments as one of our disbursements in connection with the pending tax matters" (R. 1746, 1288). Thus *defendant* paid Curry in order that, as *plaintiff's* president, he might help *defendant* in its tax matters. Defendant also paid Curry a small pension (R. 653). Curry remained with the Whitman Ransom firm until the latter part of 1948 (R. 656). During the time when Curry should have safeguarded plaintiff's interest against encroachments by defendant, he was thus an officer and director of defendant and his livelihood depended solely on defendant.

John F. Wienken was plaintiff's only other officer, to wit, secretary; and he remained such until May 1, 1945 (R. 1719). He was also a director of plaintiff until April 25, 1945 (R. 1720). Although adorned with these weighty titles, Wienken was actually a stenographer (R. 648) employed by both plaintiff and defendant in the joint New York office. Since June 1, 1943, his \$2,875 annual salary was paid solely by defendant (R. 1735, 1738).

Mary C. Valouch became the secretary and a director of plaintiff on May 1, 1945, upon Wienken's resignation and the closing of the New York office (R. 1719, 1720). For

many years before that date, Valouch had been a clerk in the employ of defendant (R. 530); she handled the Western Pacific tax matters and did secretarial work (R. 647). Since June 1, 1943 she received her salary—less than \$3,000 annually—solely from defendant (R. 1735, 1738). Upon the closing of the New York office and her appointment as secretary and a director of plaintiff, she moved—together with Curry—to the Whitman Ransom firm and became its employee (R. 530, 652).

Each of the three officers of plaintiff—Curry as president, and Wienken, succeeded by Valouch, as Secretary—was thus during the critical period in the employ and pay of defendant and subject to the inevitable tug of loyalty to his paymaster. By the very nature of their employment they were nothing but dummies and figureheads.

(d) *Plaintiff's directors.* Nine persons were, during all or part of the critical period from 1944 to 1945, directors of plaintiff: Curry, Wienken, Valouch (from May 1, 1945). Schumacher, Sheehan (from February 15, 1944), Hatton Osborn, Wood and Campbell (until May 1, 1945) (Pl. Ex. 22, R. 1720).

Three of these—Curry Wienken and Valouch—have been discussed and their financial dependence on defendant shown.

Thomas M. Schumacher was the real “boss” of the New York office before and during the critical period (R. 639 736). Since 1927 he had been the chief executive officer and a director of both plaintiff and defendant (R. 735) and in 1935 the bankruptcy court appointed him as one of the two reorganization trustees of defendant (R. 735). On February 1, 1942—before the critical period of the consolidated returns here involved—Schumacher resigned as plaintiff's president because of plaintiff's inability to pay his \$15,000 salary (R. 743). Nevertheless, in his capacity as compensated trustee for defendant (R. 738-9), Schumacher continued “in command of the New York office

(R. 736) until December 31, 1944, when defendant emerged from the reorganization and Schumacher retired (R. 1724) with a \$12,000 pension from defendant (Pl. Ex. 34-C). Although no longer an officer of plaintiff, Schumacher continued as a member of its board of directors until his death in early 1948. Throughout the critical period Schumacher was paid only by defendant, not by plaintiff (R. 645).

Catherine Sheehan was the telephone operator, receptionist and filing clerk in the joint New York office (R. 647, 138). Her \$2,000 salary was paid solely by defendant (R. 1138-9, 1738). She was elected to plaintiff's board in order to fill a quorum (R. 1139), never took part in the discussions of the board and, in casting her vote, simply followed the majority (R. 1140).

William W. Hatton was a minor officer of the Denver Railroad (R. 1134), charged with "purely clerical" duties at a salary of \$4,500 (R. 1137). Schumacher was his superior and chief" (R. 1135). Hatton—like Sheehan—was elected to plaintiff's board in order to fill a quorum (R. 1137-8); he never participated in board discussions and simply voted with the majority (R. 1136).

A. Perry Osborn was not only a director of plaintiff since 1937 (R. 988), but also a director and member of the executive committee of defendant to November 20, 1944 (R. 992).

Willis D. Wood was a long time friend of Arthur Curtiss James, at whose request he had joined plaintiff's board (R. 1123). During the period 1943-45, Wood and his family owned substantial amounts of defendant's securities (Int. Ex. 11, R. 2138-2141), but none of plaintiff's, except qualifying shares (Pl. Ex. 17, R. 1717). Since the Supreme Court's decision of March 15, 1943, he considered plaintiff a "non-entity", so that "there was no action necessary on its part, and hence I did not give it the attention that I did in former years" (R. 1130-1).

H. Brua Campbell, an attorney, was a partner of the New York law firm of Pierce & Greer (R. 532-3), which, as will presently be stated more fully, were attorneys for both plaintiff and defendant during the critical period 1944 and 1945, but received their compensation solely from defendant, nothing from plaintiff.

A clear majority of plaintiff's directors—Curry, Wienken, Valouch, Schumacher, Sheehan, Osborn and Campbell—thus owed their allegiance to defendant. All of those just named (except Osborn) received their pay solely from defendant, nothing from plaintiff. And even the two remaining directors (Wood and Hatton) were likewise by interest and allegiance oriented to defendant.

(e) *Plaintiff's lawyers*. Two New York law firms acted for plaintiff during the critical period.* Its general counsel, Pierce & Greer; and the firm of Whitman Ransom Coulson and Goetz, as tax lawyers.

Pierce & Greer. This firm, composed of *H. Brua Campbell* and *Frank C. Nicodemus* (R. 532-3), acted not only as general counsel for plaintiff (R. 533), but simultaneously as attorneys for defendant and its trustees (R. 533-6, 793). Their representation of defendant continued throughout 1945 (R. 1119-21, 2150). Since June 1, 1943 they received no compensation from plaintiff (R. 1723). They did receive an annual retainer from defendant's trustees and additional fees from defendant (R. 534-8, 1730-1, 1738).

Defendant and its bankruptcy trustees never made any bones about their conception of the duties of the Pierce & Greer firm in tax matters: They looked to the firm "to cooperate with Mr. Matthew, general counsel for the Trustees [of defendant], in protecting the trust estate [i.e. defendant] in the preparation of the final return" (Pl. Ex 39-A, R. 543-4).

* A California attorney, Judge Marcus C. Sloss, was retained by plaintiff in 1934 solely to represent its interests as a stockholder and unsecured creditor in the reorganization proceedings of defendant by opposing the I. C. C.'s plan of reorganization (R. 1603, 1611). He had nothing to do with plaintiff's taxes (R. 1603-4).

Much later, on October 10, 1946 (simultaneously with the commencement of this action), Nicodemus became a director of plaintiff.

Whitman Ransom Coulson and Goetz. In March 1943 this firm was retained as tax counsel for the Western Pacific group, including both plaintiff and defendant (Pl. Exs. 39-A to 39-E, R. 543-547; R. 556). The firm continued as tax counsel for plaintiff until at least 1947 (R. 1438-41); and they are still tax counsel for defendant (R. 1438). The partners in charge of the tax work were *Robert E. Coulson* and *James K. Polk* (R. 1399).

The firm's compensation for its tax work was paid exclusively by defendant (R. 548-557); nothing was paid by plaintiff (R. 1721). But the firm was tied to defendant by even more profound considerations.

For nearly twenty years the firm had been personal counsel to Arthur Curtiss James and general counsel to the various corporations created by him (R. 536, 962); Coulson was an officer and director of these corporations (R. 964). As attorney for the A. C. James Company, Coulson took an active part in all steps of defendant's reorganization (R. 963); in 1943 he became a member of defendant's reorganization committee which was charged with effectuating and consummating the reorganization plan (Pl. Ex. 10, p. 1674, 1677); and in December 1944 he became a director of defendant (R. 548). By reason of their large financial stake in defendant, the James Interests, represented by Coulson's firm, were vitally interested in defendant's welfare, including its taxes (R. 965); while, since the Supreme Court's decision of March 15, 1943, their interest in plaintiff was negligible; so that, as we have shown, the James Interests cast their lot with defendant and abandoned plaintiff (*supra*, pp. 11-12).

It is therefore understandable—although hardly excusable—that Polk, while attorney for both plaintiff and defendant, thought “my responsibility was to them [defendant] and not to the corporation [plaintiff]” (R. 1431).

This distorted view of a lawyer's duty to his client accorded with Coulson's ante-litem expression that his firm was dealing with the tax matters "in behalf of The Western Pacific Railroad Company [i.e., defendant]" (R. 529) and that plaintiff was "without financial stake" in the consolidated returns (R. 1744). Indeed, even after this action and the New York stockholders' suit had notified Coulson of plaintiff's "financial stake", he persisted in taking sides with one client, defendant, against the other client, plaintiff. For on December 11, 1946—while he and his firm were still actively representing plaintiff in the tax matter (R. 1438-41)—Coulson assured counsel for defendant that his interest was "solely in protecting the operating company" [i.e., defendant] in connection with this and the New York litigation (Int. Ex. 9, R. 2133-4).

To summarize: Plaintiff's entire personnel—its dominant stockholders, its officers, its directors and its lawyer—was infected with dual allegiance which prompted them in any conflict of interest between plaintiff and defendant to give their first and foremost loyalty to defendant. We proceed to show how the conduct of these persons in handling the tax transactions was actually influenced by their divided loyalties.

5. Duality in action in the handling of the consolidated returns.

The handling of plaintiff's tax matters for 1943 and 1944 confronted plaintiff with a number of grave questions. Should plaintiff make the tax credit arising from its stock loss available to defendant by filing consolidated return? Would plaintiff derive any benefit from so doing? If not, was plaintiff entitled in fairness to any such benefit? Should plaintiff secure a fair share of the tax savings by insisting on an agreement with defendant giving it a fair share?

Important as these questions were, plaintiff was not permitted to pose, let alone to answer them. Without

much as asking plaintiff, *defendant* made the decision that plaintiff was to file consolidated returns and make its tax credit available to defendant (R. 1448-1450, 1278). Plaintiff's role was confined to the mechanical, unquestioning and uninformed execution of defendant's decision.

(a) *The returns for 1943.* The thought of utilizing plaintiff's stock loss as a tax deduction in consolidated returns was first suggested in Polk's letter of May 20, 1943, addressed to *defendant* (Pl. Ex. 50, R. 1757, 1760-1). The letter did not mention that plaintiff might have to be consulted.

By December 1943, Coulson and Polk were prepared to recommend definitely the adoption of Polk's suggestion (R. 1409-10). They made their recommendation—but only to *defendant*. Early in January, 1944, Polk traveled to the west coast where defendant's principal office was located, and there advised the trustees and officers of *defendant* that the use of plaintiff's stock loss in a consolidated return would eliminate all 1943 taxes (R. 1267-8, 1410-11, 1448). Defendant, although quite unconcerned about plaintiff's concurrence in the plan, was concerned about the legal soundness of Polk's advice and therefore requested a formal opinion of the Whitman Ransom firm (R. 1268, 1411). On January 11, 1944 Coulson sent this opinion from New York to *defendant* (Pl. Ex. 54, R. 605)—with not even a copy to plaintiff (R. 665). The opinion assumed, as a matter of course, that plaintiff would join in consolidated returns and would bestow upon defendant the tax benefits flowing from plaintiff's stock loss.

Defendant was satisfied with this opinion. Without bothering to ask for plaintiff's permission, defendant simply decided * to use plaintiff's tax credit to eliminate its own taxes (R. 1448). Defendant at once acted pursuant to this decision. It reversed, in January, 1944, tax accruals of about \$7,500,000 theretofore placed on its books

Defendant's decision (R. 1448) was made by Elsey, its president (R. 1251), and by DeGraff, its general auditor (R. 1408).

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for 1943 (R. 873, 1770). In March 1944 it advised the bankruptcy court that no taxes would be payable for 1943 (Pl. Ex. 58, R. 1772). And in May, 1944—still before the 1943 returns were filed—defendant stated in its report to stockholders that plaintiff “can and will” file consolidated returns in which plaintiff’s stock loss “will result in elimination” of defendant’s tax liability (Pl. Ex. 20-B, R. 512).

Who, then, decided on behalf of plaintiff that it “will” file such consolidated returns? Its board of directors did not; the 1943 tax matters were never presented to plaintiff’s board, either for discussion or decision (R. 1018). Nor did its then two officers, its president Curry, and its secretary Wienken. The latter had nothing at all to do with taxes; and Curry was a mere “figurehead”, a “signing officer”, and completely ignorant of tax matters (“tax matters were wholly Greek to me. I didn’t understand them at all * * *”, R. 808).

The method by which defendant caused plaintiff to file the consolidated returns for 1943 was simple. After *defendant* had resolved that plaintiff would file the consolidated returns utilizing its stock loss (R. 1448, 1278), such returns were prepared by Valouch (then a full time employee of *defendant*, but neither an officer or director of plaintiff), under the supervision of Polk (R. 663). The completed returns were given by Valouch to Curry for his signature (R. 664). At Curry’s question, Valouch assured him that Polk had approved the returns (R. 664). Thereupon Curry, without questioning Polk or his firm as to why plaintiff should endow defendant with the stupendous gift of this tax saving; without his asking or even thinking whether it would not be fair for plaintiff to receive the tax savings or at least a part thereof, as an offset against its huge loss; without giving any thought to the wisdom of retaining independent counsel to ascertain and protect plaintiff’s rights against defendant; and without bothering to consult plaintiff’s directors—Mr. Curry, the “signing officer”, did just that: He signed (R. 664).

(b) *The returns for 1944 and the refund claim for 1942.*

The story for the 1944 returns is much the same as for the preceding year. Plaintiff's board was not consulted; it never considered or decided on the filing of consolidated returns (R. 1018). What happened was that on December 20, 1944 Coulson advised *defendant*—but not plaintiff—by telegram that “the only course open is to proceed as indicated in conversations with you, including report on the consolidated basis up to May 1 [1944]” (Pl. Ex. 62, R. 623). Thereupon the decision to file consolidated returns for the first four months of 1944 was made by *defendant*—not by plaintiff (R. 1449-50). The returns were then prepared in Polk's office and brought to Curry for his signature (R. 666). At that time Curry had moved to the Whitman Ransom suite with instructions from Coulson to “put himself at Polk's disposal” (R. 1498); and this meant that, under his retainer, he, as plaintiff's president, was to perform such services, as defendant would require to achieve and safeguard the tax savings for itself. Hence when Curry was told that Polk wanted him to sign the returns, he obliged—again without asking plaintiff's board of directors (R. 666).

The refund claim for 1942 was prepared with even less ceremony than the tax returns. Polk himself decided that plaintiff should file such a claim (R. 1450). He prepared the claim; placed it before “the proper signing officer”, i.e., Curry, with the request for his signature (R. 1450); and Curry signed, again, of course, without benefit of consultation or approval by plaintiff's board of directors (R. 666-7).

That Curry, in signing, was preoccupied with defendant's interests, not plaintiff's, is indisputably established by his own contemporaneous statements. Plaintiff was confronted in February, 1945, with a possible forfeiture of its charter for non-payment of Delaware franchise taxes. Curry, in discussing the problem, gave serious consideration to it—but only with an eye to defendant's tax savings and their possible jeopardy; and without any thought to

the interests of plaintiff and its stockholders. This is clearly stated in a letter from Curry, as plaintiff's president, to Nicodemus, copy to Polk (Int. Ex. 5, R. 2125-7):

"If we default and our charter is voided, the question arises what would be the effect on the consolidated income and excess-profits tax returns filed by the Corporation, as parent, for the years 1942, 1943 and 1944. As you know, a very large deduction was taken in 1943, which wiped out any tax liability for that year and will also have an effect upon the 1942 and 1944 consolidated returns. I understand the total tax saving to The Western Pacific Railroad Company [i.e., defendant] will amount to about 15 million dollars. Therefore, I feel the payment or non-payment of these franchise taxes must be determined particularly from the Federal income tax angle.

"I would suggest that before arriving at a decision in this matter you confer with the firm of Whitman, Ransom, Coulson & Goetz, our tax counsel, who are aware of this situation and are considering the consequences which the non-payment of these franchise taxes would have from an income tax viewpoint."

The same thought had long before been expressed by Coulson and Polk.* Coulson therefore decided that plaintiff's franchise tax must be paid; and the A. C. James Company—departing in this instance from its policy of making no further advances to plaintiff (R. 575-6)—loaned plaintiff the funds to pay its franchise tax (R. 713):

(c) *The tax settlement with the Government.* The proceedings culminating in the 1947 settlement of the tax dispute with the Government further illustrate the extent to which defendant managed plaintiff's tax affairs with complete disregard of plaintiff.

* On May 26, 1943, Polk advised Nicodemus that plaintiff's "dis-solution should be deferred * * * as tax aspects warranted" (R. 601). On June 26, 1943, Coulson asked Polk whether "it would be embarrassing in the Western Pacific situation" if plaintiff's charter were cancelled for failure to pay its Delaware franchise tax; Polk replied "it is essential, to protect the possible use of the net loss carry-back, that the holding company [i.e., plaintiff] continue until the consummation of the reorganization" (R. 592).

In 1945 and the early part of 1946, an Internal Revenue agent audited the tax returns for 1942-1944 (R. 1419). For his discussions with the Government Polk needed a power of attorney from plaintiff (R. 1424). Polk drafted such an instrument (Pl. Ex. 65, R. 1784). Among other things it authorized Polk and two of his partners to "execute closing agreements", i.e., to settle any tax dispute. At Polk's request, Curry, then lodged in Coulson's office, signed this power of attorney—again, of course, without consulting plaintiff's board and without the board's knowledge or approval (R. 667-8, 1025-6). Significantly, Curry felt that the signing of the power of attorney was one of his duties under his retainer agreement with the Whitman Ransom firm (R. 906) under which the latter paid him \$3,000 annually, for the account of defendant.

Armed with this power of attorney, Polk entered upon his discussions with the Government (R. 1424-5). At a conference in Washington on February 11, 1947 Polk suggested the possibility of a settlement (R. 1427-8). When the Government representative asked Polk to put his offer in writing, Polk replied that he would get authorization to do so (R. 1427). Polk promptly proceeded to procure such authorization—but only from *defendant*, not from plaintiff (R. 1429-31). He immediately telephoned Coulson, who at the time was in San Francisco, and outlined to him the proposed offer (R. 1429-30). Coulson at once consulted *defendant's* president Elsey, who, in turn, canvassed *defendant's* directors (R. 1282-4). After a few hours Elsey advised Polk by telephone that his proposed settlement offer was approved by *defendant* (R. 1430). Polk at once reduced his offer to writing and, in *plaintiff's* name, submitted it to the Government (R. 171, 1430). The thought that plaintiff might have to be consulted occurred, they say, to no one (R. 1431). Until two months later plaintiff's directors and officers had no information whatever of what was being done in their names (R. 668-9).

This patent disregard of plaintiff's rights was also manifested in the terms of Polk's settlement offer. At the

time the offer was made (February 11, 1947), the present action was already pending and defendants had filed their answers asserting certain technical defenses, such as the statute of limitations (R. 28-29). But these technical defenses would obviously have been unavailable as to any moneys which might come directly into plaintiff's possession and as to which, therefore, plaintiff would not have to sue defendant. The 1942 tax savings were of that character. The refund claim for 1942 (R. 1654) was, and had to be, filed by plaintiff; if the claim had been allowed by the Government, the \$4,201,821.54 taxes for 1942 would have been paid by the Government to plaintiff.* The refund claim was therefore particularly valuable to plaintiff since the 1942 tax moneys, if collected by plaintiff from the Government, were not subject to defendant's technical defenses. Polk's settlement proposal provided that plaintiff was to surrender its refund claim for 1942, whereas defendant was to be freed of any tax liability for 1943 and the first four months of 1944 (R. 171-3). The proposed settlement was thus to be accomplished wholly at plaintiff's expense.

Not until two months later, after a conference with defendant on April 2, 1947, did it occur to Polk to notify plaintiff of the settlement offer which he had made in its name, and to request the approval of plaintiff's board (Pl. Ex. 68, R. 1788, 1460-1). The board members, alerted by our New York shareholders' action to their possible personal liability, appointed a three-man committee to consider the settlement offer. On May 5, 1947 Curry, on behalf of the Committee, notified Polk that they were "prepared to recommend" to plaintiff's board the sending to Polk of a "letter of general approval", but demanded a stipulation by defendant which would assure to plaintiff its day in court, free of the technical defenses asserted in

* Treas. Reg. 104, § 23.16(a), provides that, with respect to consolidated returns, the Government deals only with the parent corporation of an affiliated group, and that refunds will be made directly to the parent.

defendant's answers (Pl. Ex. 69, R. 1794). In effect, this letter instructed Polk not to proceed with the settlement until such a stipulation between plaintiff and defendant were made.

These instructions from his client and principal made no impression on Polk. Without waiting for the stipulation or for plaintiff's "letter of general approval", without, indeed, further asking or even notifying plaintiff (R. 681, 1027-8), Polk, on May 19, 1947, again acting as plaintiff's attorney in fact, renewed his settlement offer to the Government in the identical terms of his previous offer (Pl. Ex. 71, R. 1799). On August 13, 1947 the Government accepted Polk's offer (R. 174, 1437). The settlement thus became an accomplished fact, without ever having received advance approval by plaintiff.

(d) *Stipulation and pre-trial order concerning the effect of the tax settlement.* Promptly upon learning of the settlement in August, 1947, the intervenors moved the Court below for an order restraining its consummation (R. 163). In the face of this application, and after hearings before the District Court on August 25 and 26, 1947 (R. 164), plaintiff and defendant entered into a stipulation dated September 3, 1947 (Pl. Ex. 7, R. 1658), approved and strengthened by a pre-trial order of the District Court (R. 163, 166), to the effect that this litigation shall be decided as though plaintiff's \$4,201,821.54 refund claim for 1942 had been allowed and paid by the Government, but diminished in the proportion in which the total tax savings were diminished by the settlement. In other words: The settlement with the Government reduced the total tax savings from \$21,000,000 to \$17,000,000, i.e., by $\frac{4}{21}$. As between the parties, the \$4,261,821.54 refund claim shall be deemed reduced by $\frac{4}{21}$ thereof, i.e., to \$3,401,474.58. The litigation shall be decided as though this \$3,401,474.58 had been paid by the Government to plaintiff and had been deposited by plaintiff in Court.

The importance to this litigation of the pre-trial order and stipulation is considerable, as will be shown.

(e) *Defendant's \$10,100,000 reserve for this litigation.* At the time the consolidated returns herein were filed in 1944 and 1945 defendant anticipated a tax controversy with the Government and therefore created a \$10,100,000 tax reserve, which it invested in United States Treasury Savings Notes (R. 616-7).

After the tax settlement with the Government in 1947, defendant continued this \$10,100,000 tax reserve as a reserve against the outcome of this litigation (R. 517-8, 617).

Specification of Errors Relied Upon

1. The District Court held that the Government was improperly deprived of taxes due it and that the injustice to the Government cannot be cured by committing the further inequity of distributing the gain thus made to others.

This holding, we contend, was error.

2. The District Court held that the allowance of plaintiff's claim would permit it to share in the earnings realized by defendant during its reorganization, contrary to the decree confirming defendant's reorganization plan (R. 274-5).

This holding, we contend, was error.

3. The District Court held—or at least intimated—that there was “some merit to defendant's contention that a firm obligation rested upon plaintiff” to join defendant in the filing of consolidated tax returns (R. 275).

We contend that this holding, if it was intended as such, was error.

Summary of Argument

We propose to show:

1. Defendant was obligated to deal fairly with plaintiff because of the duality of management (Point I).
2. Fairness required defendant to allow plaintiff all or at least a substantial part of the tax savings (Point II).
3. The grounds upon which the District Court dismissed the action were erroneous (Point III).

POINT I

Defendant was obligated to deal fairly with plaintiff because of the duality of management.

The parties, engaging in the tax transactions we have described, did not deal at arm's length. That was prevented by the duality of their personnel and the dominant role of defendant in the tax transaction. We contend that, acting in this position, defendant was required by law to treat plaintiff with the highest degree of fairness; that defendant's duties to plaintiff were those of a fiduciary to his *cestui*; and that the dealings between the parties are subject to close and jealous judicial scrutiny.

Under this pointhead we shall demonstrate the existence and scope of defendant's duties; under the next, their violation by defendant.

1. The duality rule.

(a) Throughout the critical period during which the consolidated returns and the refund claim were filed (July 15, 1944 to June 15, 1945), the management of plaintiff was shot through with divided allegiance to defendant. The

rule is deeply imbedded in our law that the existence of interlocking managements between two corporations will create a fiduciary relation between them.

Geddes v. Anaconda Copper Mining Co., 254 U. S. 590, 599 (1921), contains the classical and most frequently cited formulation of the doctrine:

“The relation of directors to corporations is of such a fiduciary nature that transactions between boards having common members are regarded as jealously by the law as are personal dealings between a director and his corporation; and where the fairness of such transactions is challenged, the burden is upon those who would maintain them to show their entire fairness; * * * This court has been consistently emphatic in the application of this rule, which, it has declared, is founded in soundest morality and, we now add, in the soundest business policy. *Twin-Lick Oil Co. v. Marbury*, 91 U. S. 587, 588; *Thomas v. Brownville, Ft. K. & P. R. Co.*, 109 U. S. 522; *Wardwell v. Union P. R. Co.*, 103 U. S. 651, 658; *Corsicana Nat. Bank v. Johnson*, 251 U. S. 68.”

The rule is of universal application. It has been recognized by this Court, *Geddes v. Anaconda Copper Mining Co.*, 245 Fed. 225, 235-6 (C. C. A. 9, 1917), rev'd on other grounds 254 U. S. 590, in holding

“that upon principle contracts between corporations having a common director should be regarded very much as are contracts between individual directors and their corporations, and that while such contracts are not prohibited, and are not prima facie void or fraudulent, they are voidable, and that the burden rests upon those who seek to sustain them to show clearly and satisfactorily that they are entirely fair and free from wrong.”

The law is the same in Delaware, where plaintiff is organized; in California, where defendant is incorporated; in New York, where plaintiff's officers functioned and the returns were filed; and in other jurisdictions throughout the land.

- Keenan v. Eshleman*, 23 Del. Ch. 234, 243-4, 2 Atl. 2d 904 (S. Ct., 1938);
- Kennedy v. Emerald Coal & Coke Co.*, 42 Atl. 2d 398, 402 (S. Ct., Del., 1944);
- Goodell v. Verdugo Canon Water Co.*, 138 Cal. 308, 71 Pac. 354 (1903);
- Title Ins. & Tr. Co. v. California Development Co.*, 171 Cal. 173, 205-6, 152 Pac. 542 (1915);
- Chelrob v. Barrett*, 293 N. Y. 442, 460-2, 57 N. E. 2d 825 (1944);
- Globe Woolen Co. v. Utica G. & E. Co.*, 224 N. Y. 483, 489-90, 121 N. E. 378 (1918, Cardozo, J.);
- Mayflower Hotel Stockholders Protective Committee v. Mayflower Hotel Corp.*, 173 F. 2d 416, 418-423 (App. D. C., 1949, with numerous references).

The rule rests on wisdom, as old as Holy Writ, that "no man can faithfully serve two masters, whose interests are or may be in conflict"; *San Diego v. San Diego & L. A. R. Co.*, 44 Cal. 106, 113 (1872). Just as there is danger that a director, in dealing with his corporation, will favor his personal interests, so in transactions between interlocking corporations "the danger to be avoided is that a director or group of directors, common to two corporations, may, for reasons of self-interest, favor one of the entities in its dealings with the other"; *Mayflower Hotel* case, *supra*, 173 F. 2d, at 420. Hence, courts impose "the most careful scrutiny of transactions between the corporations represented by common directors, to the end that in the absence of arm's length bargaining, the scales may not, even through mistake or inadvertence, be unfairly tipped to one side or the other"; *Chelrob v. Barrett*, *supra*, 293 N. Y., at 461.

Hence we contend that the mere fact of the duality of the parties' personnel subjected defendant, in its dealings with plaintiff, to the strict duty to treat plaintiff with the highest degree of fairness and loyalty.

(b) But even beyond the mere duality, defendant's duty was here further strengthened by the dominant role which it assumed in the tax transactions. We need not repeat that the decision to use plaintiff's tax credit for the elimination of defendant's taxes was made by defendant, not by plaintiff; that plaintiff's board was never consulted; and that Curry, who signed the returns and the refund claim, while nominally president of plaintiff, was actually but a clerk and office manager, a full-time employee of defendant, in the exclusive pay of defendant, acting at the behest of defendant conveyed to him by tax counsel for defendant.

One who, like defendant, takes such dominant part in the affairs of another becomes his fiduciary. Thus a stockholder, not ordinarily a fiduciary of his corporation, is treated as such in any transaction in which he dominates the corporation's conduct; *Pepper v. Litton*, 308 U. S. 295, 306 (1939); *Kavanaugh v. Kavanaugh Knitting Co.*, 226 N. Y. 185, 194-5, 123 N. E. 148 (1919). A non-stockholder wielding such influence, no matter by what means, is subject to the same duties. "It is the fact of control * * *, not the particular means by which or manner in which the control is exercised, that creates the fiduciary obligation"; *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919, Brandeis, J.).

Thus in *Title Insurance & Trust Co. v. California Development Co.*, 171 Cal. 173, 152 Pac. 542 (1915), the Southern Pacific Company held no stock in the Development Company, but had made large loans to it, reserving the right to appoint three of the latter's seven directors. This was held to have placed the Southern Pacific Company "in a position of effective domination" over the Development Company (171 Cal., at 205). The Court went on:

"Having such control and dominion * * *, the Southern Pacific Company occupied a fiduciary relation toward the California Development Company and its stockholders and creditors. * * * The Southern Pacific Company, by thus taking control of the directorate and the business of the development company, ren-

dered itself subject, at least, to the restrictions which are imposed upon a director of a corporation." (171 Cal., at 206)

The present defendant's domination of plaintiff in their tax transactions was no less. It follows inevitably that defendant owed plaintiff the strictest duties of a fiduciary.

2. Scope of the duality rule.

Defendant does not deny that the parties operated under interlocking managements; nor does it question the duality rule as such. To escape its consequences, defendant argues for certain exceptions which, it says, should here be grafted upon the ancient fiduciary standards—in defiance of the "uncompromising rigidity [which] has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the 'disintegrating erosion' of particular exceptions", *Meinhard v. Salmon*, 249 N. Y. 458, 164 N. E. 545 (1928, Cardozo, J.).

We shall briefly discuss defendant's claimed exceptions.

(a) *Good faith*. Defendant says that the dual personnel was honest and free from evil motive. But judicial scrutiny of the fairness of a transaction between interlocking corporations will not be forestalled by a showing that the common officers acted honestly and in good faith.

Chelrob v. Barrett, *supra*, 293 N. Y., at 460-2;

Overfield v. Pennroad Corp., 42 F. Supp. 586, 610 (D. C., E. D. Pa., 1941), *rev'd* on other grounds 146 F. 2d 889;

Blum v. Fleishhacker, 21 F. Supp. 527, 533 (D. C., N. D. Cal., 1937), *mod. and aff'd* 109 F. 2d 543, *cert. den.* 311 U. S. 665;

Bernheim v. Louisville Property Co., 185 Ky. 63, 73, 214 S. W. 801 (1919).

In each of these cases the courts paid tribute to the good faith and honesty of the dual actors as well as to their independence and freedom from domination; they simultaneously imposed the fiduciary duty to deal fairly and found its breach.

Indeed, the rule could not be otherwise. Duality works in an insidious fashion. Even if it does not corrupt the honesty of the dual agent, it may insensibly dampen the exertion of his best skill and ingenuity. Thus defendant here asserts that dual tax counsel never had any thought of plaintiff's right to the tax savings (R. 1433, 1473-5). Assuming these protestations, they merely emphasize the deadly effect of divided allegiance. For the evidence shows that tax counsel had at hand all the information which might lead him to the realization of plaintiff's rights.* His failure to realize them may well have been due to a lack of wholehearted devotion to plaintiff's cause. To say whether it was or not, would involve that "calculus of probabilities [which] is beyond the science of the chancery", *Meinhard v. Salmon*, *supra*, 249 N. Y., at 465. Hence the rigid rule of prophylaxis which, in the presence of duality, requires absolute fairness, regardless of subjective honesty and good faith.

(b) *Absence of secrecy*. Defendant denies any attempt to conceal the tax transaction from plaintiff. But dealings between interlocking companies, unless found altogether fair, will not be saved by the absence of secrecy. As held in *Blum v. Fleishhacker*, *supra*, 21 F. Supp., at 533, "the question of secrecy is immaterial. * * * the publicity alone of an illegal or unauthorized act of the directors of a

* As we shall later show, the problem of an inter-company adjustment of tax savings was not uncommon. It arose, just during the critical period, under the S.E.C.'s Rule U-45(b)(6) and was treated in several S.E.C. decisions. In 1943, Polk was familiar with Rule U-45(b)(6) and referred to it in giving advice concerning the tax allocation of the Western Pacific group (R. 1466-7). Copies of the S.E.C. decisions, discussed below, were received by Polk's firm at the time they were released between June, 1943 and January, 1945 (R. 1467-8).

corporation does not make it legal or valid". Accord: *Goodell v. Verdugo Canon Water Co.*, *supra*, 138 Cal., at 314.

Moreover, as to the alleged absence of secrecy it might be noted that defendant was quite reluctant to disclose its use of plaintiff's tax credit. It will be recalled that, when defendant resolved to pay no taxes for 1943, it simultaneously decided to create a tax reserve; but this reserve was to be hidden under the unrevealing designation "Reserve for Road Improvements" (Pl. Ex. 53, R. 1770; Int. Ex. Ident. 19, R. 2155-6). This camouflage proved unfeasible; but defendant nevertheless issued a directive to its officers to withhold all information regarding the source of its tax saving (Int. Exs. Ident. 18-B and 18-C, R. 2152-4). The first public disclosure was defendant's 1943 report to its stockholders (Pl. Ex. 20-B) which, although dated May, 1944, was not released until July, 1944 (R. 1278)—too late for any independent stockholder of plaintiff to take action before the 1943 tax returns were filed on July 15, 1944.

(c) *Origin of duality.* Defendant says that plaintiff cannot invoke the duality rule because plaintiff itself created the duality. The argument assumes that plaintiff appointed defendant's officers and directors and therefore cannot complain of their identity with its own management.

Actually, however, plaintiff had, during the critical period, no say in the selection of defendant's management. During defendant's reorganization, its trustees, directors and officers were appointed by the bankruptcy court. And after defendant emerged from reorganization in December, 1944, its management was selected by its new stockholders, not by plaintiff.

In any event, it is immaterial who created the duality. There is nothing invidious about interlocking managements as such. Indeed, "business convenience many times requires interlocking directorates"; 3 *Fletcher Cyc. Corp.* (Perm. Ed., 1947) § 961, p. 433. But once duality is created—no matter by whom or how innocently—it subjects the entities

to fiduciary standards in their dealings with each other; *In re James Estate*, 86 N. Y. S. 2d 78 (Surr. Ct., 1948). Even though a parent corporation, for business convenience, has created duality, nevertheless it is held protected from unfair treatment in transactions with its own subsidiary. *Potter v. Sanitary Co. of America*, 22 Del. Ch. 110, 194 Atl. 87 (1937); *Banco Kentucky Co.'s Receiver v. National Bank of Kentucky's Receiver*, 281 Ky. 784, 137 S. W. 2d 357 (1939).

(d) *Officers of the court.* During defendant's reorganization, its affairs were managed by two court-appointed bankruptcy trustees; and defendant's dual employees were, technically, the employees of the trustees. Defendant asserts that the normal duty of the court to review transactions consummated by dual actors does not apply where the dual actors are, or work for, trustees appointed by the court. This is said to be so because a court-appointed trustee has no personal ax to grind; no self-interest; no concern except to be just and objective.

This contention is novel; it is contrary to common sense; and it is contrary to the authorities. Defendant in effect argues that the unfairness found by the courts in the *Chelrob*, *Pennroad* and *Bernheim* cases, *supra*, would have been beyond the power of the court to redress if the dual management had been appointed or employed by a court trustee. We believe that the strict supervision exercised by a court over its officers argues for the opposite conclusion.

In *Koral v. Savory, Inc.*, 276 N. Y. 215, 11 N. E. 2d 883 (1937), a stockholder brought a derivative action on behalf of a corporation whose affairs were in the hands of a court-appointed receiver. A demand by the plaintiff that the receiver bring the suit had been refused. The defendants demanded dismissal of the action as an improper interference with the discretion exercised by the receiver. But the court sustained the complaint (276 N. Y., at 220):

"Here the complaint alleges facts which, if true, show that the refusal is not due to an 'unprejudiced exercise of judgment,' but on the contrary that the receiver is a clerk in the office of the attorneys for the defendants and that his primary interest is to prevent the corporation from redressing the wrongs committed by the clients of his employer."

The court thus unhesitatingly applied the rule of duality to an officer appointed by the court; and the same course has been adopted whenever the question arose. *In re Los Angeles Lumber Products Co.*, 46 F. Supp. 77, 88 (D. C., S. D. Cal., 1941); *In re James Estate*, *supra*, 86 N. Y. S. 2d 78; *Brinckerhoff v. Bostwick*, 88 N. Y. 52, 60 (1882).

3. Application of the fiduciary rule to tax transactions.

Fiduciaries who mishandle a company's tax affairs or derive private tax advantages from their management of the company's tax business, are subject to the same accountability as in other transactions with their *cestuis*.

Commercial National Bank in Shreveport v. Parsons, 144 F. 2d 231, 236-7 (C. C. A. 5, 1944), reh. den. 145 F. 2d 191, cert. den. 323 U. S. 796;

Leslie v. Commercial National Bank in Shreveport, 28 F. Supp. 927, 933 (D. C., W. D. La., 1939);

Commercial National Bank in Shreveport v. Connolly, 176 F. 2d 1004 (C. C. A. 5, 1949), reh. den. 177 F. 2d 514;

Truncale v. Universal Pictures Co., 76 F. Supp. 465 (D. C., S. D. N. Y., 1948);

Mahler v. Oishei (N. Y. Co. Index No. 28485, N. Y. Sup. Ct., Nov. 12, 1947), reviewed 61 Harvard L. Rev. 1058 (1948).

Thus, in the *Shreveport Bank* cases, *supra*, the "old bank" had transferred certain real estate to the "new bank" as collateral security for claims of the new bank. Under the applicable tax laws of Louisiana, a corporation owning real estate was entitled to certain tax deductions.

The new bank, as the technical legal owner of the aforesaid real estate, claimed and procured such tax savings. But the courts held that the real estate belonged equitably to the old bank; that the new bank was the fiduciary of the old; and that it must, therefore, account for all private tax savings which it procured in the conduct of its fiduciary activities:

“The dominant officers of the new bank were the directors of the old, and they were doubly bound to treat the latter fairly.” (144 F. 2d, at 236)

“There can be little question but that the relation of the new Bank to the old and the administration of the property and estate intrusted to the former, was one requiring the utmost good faith and constituted it an agent, trustee or fiduciary. * * * It could not profit therefrom in any manner * * *.

“* * * the new Bank * * * should not be allowed to take credit for the taxes paid under the circumstances of this case.” (28 F. Supp., at 933)

In the *Truncate* case, *supra* (76 F. Supp. 465), the directors of a corporation had exercised options to buy the corporation's stock at prices far below its market value. The difference between the market value and the purchase price constituted taxable income to the directors and, at the same time, a tax-deductible expense to the corporation. The directors, in violation of their fiduciary duties, caused the corporation to waive its right to this tax deduction; the corporation's waiver enabled the directors to save substantial amounts of their private taxes. The directors were held accountable to the corporation for their tax savings, although the amount of their savings far exceeded the tax detriment which the corporation had sustained by reason of its waiver.

The present case likewise involved a tax transaction between plaintiff and defendant. Plaintiff and defendant had to agree to join in the consolidated returns, plaintiff by electing to file them, defendant by giving its consent. By

filing the returns, plaintiff made the tax credit arising from its stock loss available to reduce defendant's taxes; plaintiff surrendered thereby, *pro tanto*, its privilege to use its tax credit as a reduction of its own future taxes. Moreover, by filing the returns, plaintiff subjected itself to joint and several liability for any taxes or tax deficiencies which the Government might assess on defendant's income (Treas. Reg. 104, § 23.15(d)). In short, by joining in consolidated returns, the parties engaged in a transaction which profoundly affected their mutual rights and relations.

We submit that, in the light of the duality of plaintiff's management and the dominant part which defendant played in the tax transactions, defendant was under the fiduciary obligation to treat plaintiff with the highest degree of fairness in these tax transactions. We proceed to show that defendant breached this obligation.

POINT II

Fairness required defendant to allow plaintiff all or at least a substantial part of the tax savings.

Fairness, whatever its other connotations, demanded that defendant refrain from taking "undue advantage" of plaintiff.* The filing of the consolidated returns here conferred great advantage—a \$17,000,000 tax saving—on defendant, the fiduciary. It conferred no advantage on plaintiff, the cestui. The transaction was thus unilaterally advantageous to the fiduciary. This, we contend, was an "undue advantage" to defendant. Fairness required defendant to make an agreement allowing plaintiff a substantial share in the benefits procured by their joint action.

A more detailed analysis will support our contention.

* *Sheehan v. Erbe*, 77 App. Div. 176, 79 N. Y. S. 43, 45 (1st Dept., 1902).

A

The purpose of the tax law was to benefit plaintiff.

The fairness of a transaction allocating tax benefits between two private parties will in considerable measure depend upon the purpose of the tax law which creates the benefit. Thus if the enjoyment of the \$17,000,000 tax saving by defendant, and the denial of any share therein to plaintiff, accorded with the purpose and philosophy of the tax law, then there is much to be said for the fairness of the transaction as between the parties. If, however, defendant's enjoyment of the tax saving was a mere windfall to it, made possible by the letter of the tax statute, but unsupported by its underlying purpose; and if plaintiff's enjoyment of those savings would more nearly fulfill the statutory purpose; then an agreement allowing plaintiff all or a substantial share would indeed be fair.

A brief discussion of the applicable tax laws and their purpose is therefore necessary.

1. *The purpose of § 23(g)(4) of the Internal Revenue Code.*

Prior to 1938 a loss resulting from the worthlessness of stock held by a taxpayer was fully deductible for tax purposes. In 1938 the Code was amended to make such losses "capital losses", deductible only from capital gains. In 1942, however, § 23(g)(4) was added to the Code, providing that a loss sustained through the worthlessness of the stock of an affiliate constitutes an ordinary loss, unrestrictedly available as a tax deduction from any kind of income (R. 267-8).

Defendant's stock held by plaintiff became worthless in 1943; and under § 23(g)(4), plaintiff could use this stock loss as a tax deduction.

As stated by the Court below (R. 268), the legislative history of § 23(g)(4) throws no light upon its purpose and philosophy. That purpose, however, would seem to be

self-evident: The new section was designed to mitigate the economic impact of such a stock loss. Accordingly the authorities, more fully discussed below, recognize that, realistically, the tax saving resulting from a stock loss should be viewed as a partial offset to such loss; *Matter of Consolidated Electric & Gas Co.*, 15 S. E. C. 161, 164 (1943).

Since in this case the loss was sustained by plaintiff, the tax credit arising therefrom was likewise designed for plaintiff, in order to offset its loss.

Plaintiff's management failed to take any step to effectuate this purpose. Its sole interest was to make plaintiff's tax credit available to defendant. This objective was accomplished through the filing of consolidated tax returns, with the result that plaintiff's tax credit was not used to mitigate plaintiff's loss but to confer upon defendant what the Court below called an "amazing and undeserved" tax benefit (R. 276).

This diversion of the tax credit from plaintiff to defendant was not only contrary to the purpose of § 23(g)(4); it was also, as we now proceed to show, contrary to the purpose of consolidated returns.

2. *The purpose and mechanics of consolidated returns.*

(a) Consolidated tax returns are permitted by § 141 of the Internal Revenue Code and are governed by regulations issued by the Commissioner of Internal Revenue. These returns may be filed by an "affiliated group of corporations" interconnected by at least 95% stock ownership. The privilege of filing consolidated returns is designed for the protection and benefit of the common owner, or parent, of the affiliated group. Without consolidated returns, the investor, that is, the parent company, investing in two subsidiaries, one profitable, and the other a losing proposition, would have to pay a tax on the income from its good investment, without being able to deduct its loss from the bad one. The rationale of consolidated returns

"is the recognition of this common owner's right to set off against his gains in the one [corporation] his losses in the other [corporation]";

Duke Power Co. v. Commissioner, 44 F. 2d 543, 545
(C. C. A. 4, 1930), cert. den. 283 U. S. 903.

The underlying principle has been well stated by the Court below (R. 269):

" * * * the philosophy of the consolidated return is to disregard the corporate entity and to tax as a single business or economic unit what really is a business unit * * *. It treats an affiliated group of corporations as one business enterprise, the various affiliates being considered as if they were branch offices of the main business establishment. The income from all units is considered as a single income and the losses of all units are treated as a single loss. (Citing authorities)."

The same thought is clearly expressed in the *Report of the Senate Finance Committee*, 70th Cong., 1st Sess., S. R. 960, p. 14 (1928), quoted in *Spreckels Co. v. Commissioner*, 41 B. T. A. 370, 375 (1940):

"The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise. * * * The mere fact that by legal fiction several corporations owned by the same stockholders are separate entities should not obscure the fact that they are in reality one and the same business owned by the same individuals and operated as a unit. To refuse to recognize this situation and to require for tax purposes the breaking up of a single business into its constituent parts is just as unreasonable as to require a single corporation to report separately for tax purposes the gains from its sales department, from its manufacturing activities, from its investments, and from each and every one of its agencies."

Accord:

Handy & Harman v. Burnet, 284 U. S. 136, 140 (1931);

Atlantic City Electric Co. v. Commissioner, 288 U. S. 152, 154 (1933);

Alameda Investment Co. v. McLaughlin, 28 F. 2d 81, 82 (D. C., N. D. Cal., 1928), *aff'd* 33 F. 2d 120 (C. C. A. 9, 1929).

Consolidated returns are thus permitted for the benefit of the "common owner" of the affiliated enterprise, that is, the parent corporation. They are not permitted for the benefit of the subsidiaries. If a subsidiary operates profitably it has no ground, in its own person, to seek a reduction of its taxes, even though its parent, or another subsidiary of the parent, has sustained a loss; for such loss cannot affect the financial position of the profitable subsidiary. But otherwise the common parent; in an economic sense, the profits of each member of the group are the profits of the parent, and the losses of each member of the group are the losses of the parent; the right to offset such losses and profits against each other is therefore the parent's right, created in the interest and for the benefit of the parent. As stated in the *Alameda* case, *supra* (28 F. 2d, at 82), "The benefit of the statute extends to him on whom is the hazard of the several enterprises", that is, the parent.

It is true that consolidated returns may also redound to the advantage of the subsidiary. Thus where a losing parent files a consolidated return for itself and a profitable subsidiary, the latter's taxes may be reduced. But this tax advantage is not allowed for the subsidiary's sake. It is allowed for the parent's sake which, normally, gets the full benefit of the subsidiary's tax savings by the automatic operation of economic factors—either through the increased value of the parent's stock in the subsidiary or through the declaration of dividends.

(b) In the present case, however, this intended benefit to the parent through the automatic upstream flow of the subsidiary's tax savings to the parent was stopped entirely. For the Supreme Court's decision of March 15, 1943 had destroyed plaintiff's equity in defendant, so that plaintiff, although under the tax law the intended beneficiary of its subsidiary's tax saving, received no benefit whatever. Instead, defendant, the profit-making subsidiary, reaped the entire benefit of a loss it had never suffered.

(c) How was this anomalous result possible under the tax law? The answer lies in the history and phraseology of the consolidated return statute.

Originally consolidated returns were regulated in strict accordance with their underlying purpose: They could be filed only by a group of affiliated corporations actually constituting an economic unit. See *United States v. Cleveland, P. & E. R. Co.*, 42 F. 2d 433 (C. C. A. 6, 1930), setting forth the early history of consolidated return law. In such an economic unit the automatic upstream flow of a subsidiary's tax saving to the parent was necessarily assured. But the statutory definitions of economic unity proved so vague as to be unworkable, leading to confusion and extensive litigation. In the interest of administrative convenience the test of affiliation was therefore simplified: The legal ownership by one corporation of at least 95% of the stock of another corporation was made the sole test of affiliation (Internal Revenue Code, § 141(a)). Once this requirement is met, consolidated returns may be filed even though, in exceptional cases, there is no economic unity so that the purpose of consolidated returns is not achieved.*

The present is such an exceptional case. Indeed, defendant itself and its tax counsel recognized its "unusual" and "paradoxical" character (R. 512, 1760). The economic

* *Burnet v. Aluminum Goods Mfg. Co.*, 287 U. S. 544 (1932); *George A. Fuller Co. v. Commissioner*, 92 F. 2d 72 (C. C. A. 2, 1937); *Trinity Buildings Corp. v. Commissioner*, 40 B. T. A. 1315 (1939).

unity between plaintiff and defendant was severed by the Supreme Court's approval of defendant's reorganization plan on March 15, 1943. But plaintiff still continued to own all of defendant's stock; for defendant's reorganization plan was not yet consummated; and until consummation, defendant's stock held by plaintiff was legally valid. This stock ownership, although economically a fiction, provided the legal affiliation sufficient for the filing of consolidated returns.

(d) While these tax transactions were thus proper so far as the Government was concerned, it does not follow that the results were fair as between the parties. In determining their fairness, equity is concerned with realities rather than fictions. The fact is unshakable that defendant realized a \$17,000,000 tax saving, not because of a loss of its own, but because of a loss of plaintiff. The fact is unshakable that the consolidated returns, although properly filed, failed to achieve the statutory purpose of benefiting plaintiff, the parent of the affiliated group. And the fact is unshakable that the tax credit arising from plaintiff's stock loss was designed to mitigate that loss, not to confer a huge and undeserved advantage on defendant. In short, all reasons of statutory purpose, economic logic and common fairness point to plaintiff as the intended beneficiary of these tax savings. Not a single reason justifies their retention by defendant. In defendant's hands, these tax savings are a windfall, without economic rhyme or reason—a perversion of the purposes of the tax laws.

Had plaintiff's affairs been in the hands of an unbiased and independent management, intent solely on plaintiff's interest, it might well have rejected so anomalous and unwarranted a result. It was free to refrain from filing consolidated returns; for, under the tax laws, plaintiff's was the choice to file consolidated or separate returns; and if plaintiff, the parent corporation, "decided that its best interests required filing by it of a separate return, no provision of the law denied it this privilege"; *Duke Power*

Co. v. Commissioner, supra, 44 F. 2d, at 545. An independent management of plaintiff, with these thoughts in mind, before consenting to consolidated returns and to the use of plaintiff's tax credit by defendant, might well have insisted on an agreement with defendant assuring plaintiff a fair share in the dollars to be achieved by their joint action. And defendant's management, if willing to act fairly, would have acceded to such a demand.

Indeed, as we now proceed to show, agreements of this type are, and were at the time, a familiar device and had repeatedly received administrative sanction.

B

Agreements for the fair allocation of tax savings among affiliated corporations are well supported by precedent.

The question whether the tax benefits arising from consolidated returns have been fairly allocated among affiliated companies will rarely reach the cognizance of a court, since ordinarily the affiliation is too close for inter-company controversies. The question has, however, arisen from time to time in the field of public utility holding companies under regulations issued by the Securities and Exchange Commission. Although these regulations are not directly applicable to the present parties, their administration by the S. E. C. discloses the underlying principles of fairness which sanction the present plaintiff's claim.

The S. E. C. regulation most directly pertinent is the Commission's Rule U-45(b)(6), applicable to affiliated groups of public utility companies, and specifically regulating inter-company tax adjustments. This rule directs, in effect, that ordinarily the consolidated tax payable by an affiliated utility group shall be allocated among the members of the group in the proportion of their respective net incomes, but that deviations from this formula may be permitted by the Commission. As stated by the Commission, "Rule U-45(b)(6) was designed to effect a fair distribu-

tion of taxes based on consolidated returns".* To effectuate this purpose, the Commission has approved deviations from its rule and permitted "tax saving payments", i.e., payments by a profitable affiliate to a losing affiliate for the use of the latter's tax credit. The Commission's rulings and opinions are therefore significant on the issue of fairness herein.

Matter of Consolidated Electric & Gas Co., 15 S. E. C. 161 (1943), involved an affiliated group of utility companies including a parent corporation ("Consolidated") and 44 subsidiaries. Parent and subsidiaries filed consolidated tax returns. The parent had sold the assets of nine of the subsidiaries, sustaining a large loss on its investment therein. This loss could be used as a tax reduction by reason of a 1942 amendment of the Internal Revenue Code—the same amendment which qualified the present plaintiff's stock loss as a tax deduction. If the loss sustained by Consolidated was utilized in the consolidated return, the taxes payable by the affiliated group would be reduced by more than \$2,000,000. Most of this tax saving would redound to the benefit of the subsidiaries, only a small fraction to the direct benefit of the parent.

In order to prevent the subsidiaries from receiving this undeserved windfall at the expense of their parent, the group members entered into an agreement under which the subsidiaries were to pay to their parent all of the tax savings resulting from the parent's capital loss. Since this arrangement was intrinsically fair, the Commission approved it:

"To the extent that tax savings may accrue to the parent in connection with such sales, the result is in effect to reduce the amount of loss accruing to Consolidated by virtue of the transaction." (p. 163)

* *Matter of Cities Service Company* (S. E. C. Holding Company Act Release No. 5535, January 3, 1945, File No. 70-933); see *infra*, p. 46.

“Under all the circumstances we believe that it is more realistic to view the tax savings as, in effect, partial offsets to the capital loss otherwise suffered by Consolidated in connection with the sales.” (p. 164)

Like considerations should control the case at bar. The present plaintiff, like Consolidated, sustained an extraordinary capital loss giving rise to a tax deduction. The tax deduction here, like that in the *Consolidated* case, was designed as “partial offset to the capital loss”. Just as it was fair for Consolidated to collect from its subsidiaries the tax savings which they obtained through Consolidated’s loss,* so it would have been fair for plaintiff to obtain a similar arrangement with defendant.

Indeed, the present case is much stronger than *Consolidated*. The Consolidated group—unlike the Western Pacific group—constituted an economic unit. The tax savings of Consolidated’s subsidiaries thus enured automatically to the benefit of the parent; and the Commission noted that Consolidated might have secured most of the tax benefits of its subsidiaries through the payment of dividends (15 S. E. C., at 164). The permission for tax saving payments was thus a matter of expediency rather than necessity. By contrast, the economic unity of the Western Pacific group was destroyed. Plaintiff could derive no automatic benefit from the tax saving of defendant; an agreement for the sharing of the tax savings was thus, not merely a matter of expediency, but imperatively required in the interest of fairness, to effectuate the “more realistic” view of the tax savings as partial offsets to plaintiff’s capital loss.

Matter of Cities Service Company (S. E. C. Holding Company Act Release No. 5535, January 3, 1945, File No. 70-988) contains an even broader statement of the applicable policies. Cities Service Co. was the parent of

* The tax savings paid to the parent in *Consolidated* were solely those flowing from the use of Consolidated’s stock loss. Other tax savings flowing from the consolidated return remained with the subsidiaries.

an affiliated utility group filing consolidated tax returns; Refining Corporation was a subsidiary. Under the war emergency, the Refining Corporation had built a refinery at a cost of \$77,000,000, borrowed in large part from the Reconstruction Finance Corporation. The refinery was subject to rapid obsolescence. Pursuant to special dispensation, Refining Corporation was permitted to amortize its investment, for tax purposes, over a period of five years; in other words, it had in each year a tax deduction equal to 20% of its \$77,000,000 investment. If these tax deductions were utilized in consolidated returns, they would enure to the benefit of other affiliates rather than that of Refining Corporation. This would be an undeserved advantage to those affiliates who had not, with borrowed funds, made a large investment threatened with early obsolescence. The affiliates therefore agreed to pay to Refining Corporation their tax savings derived from the latter's amortization tax credits; and the S. E. C. approved. We quote the Commission's conclusions in full:

"Conclusions

"Rule U-45 (b) (6) was designed to effect a fair distribution of taxes based on consolidated returns. In appraising a proposed deviation from our rule we think it should be observed that in the ordinary case the fact that one subsidiary contributes a particular income deduction to a consolidated return does not in itself entitle that subsidiary to the benefits of the reduced taxes resulting from the deduction. Where tax reductions are possible from filing a consolidated return, they ordinarily are due to a number of factors contributed by the various members of the consolidating group, including, among others, earnings, and excess profits tax credits, as well as income deductions.

"On the basis of the estimates of the tax liability for 1944 it appears that Refining Corporation will contribute special deductions but that the other subsidiaries will contribute the income necessary to permit full utilization of the deductions. Thus, while a portion of the tax reductions possible from consolidation could not be realized without the special amortization

items, the reduction likewise could not be realized in the absence of the income furnished by the other companies.

"Obviously it is difficult to determine the precise weight to be given to these various factors and in this case the problem is made more difficult since we have available the results of only five months' operation of the refinery.

"However, the impact of our rule in this instance and the circumstances surrounding the construction of the refinery as recited above persuade us that we should grant the exception requested if the effect in subsequent years will not cause undue detriment to the other subsidiaries of Cities. We shall therefore permit the declaration to become effective, but in order that we may have an opportunity to examine the future effects of the amended contract and take any action which may appear necessary or appropriate following such examination, our order will be subject to the condition that the proposed amendment to the contract regarding allocation of Federal income and excess profits tax liability shall cease to be effective upon order of the Commission after notice and opportunity for hearing.

"An appropriate order will issue."

This decision clearly shows that the S. E. C. was concerned with the same problem here presented, namely, "a fair distribution of taxes based on consolidated returns." The problem was further similar to ours in that the five-year amortization of the investment was tantamount to an investment loss spread over five years. The S. E. C. held that the tax credit arising from such a loss is designed to mitigate the loss; hence it found fair an agreement among the affiliates effectuating that purpose by a tax saving payment to the Refining Corporation, particularly since the latter needed that payment to discharge its loan obligation to the Reconstruction Finance Corporation. Nor was the arrangement inconsistent with the underlying purpose of the consolidated return statute to benefit the common parent of the group; for the Cities Service group was an

economic unit; hence, whichever affiliate might obtain the tax saving in the first place, it was bound to enure ultimately to the benefit of Cities Service, the common parent; and Cities Service, in its own interest, wished to channel the payment to the Refining Corporation.

In the present case the retention of the tax savings by defendant would defeat not only the purpose of the tax law to alleviate plaintiff's investment loss. It would also defeat the purpose of the consolidated return statute to confer a tax benefit on the parent company. Both purposes would be achieved if plaintiff were permitted a share in defendant's tax savings. We submit that fairness required defendant to make an agreement with plaintiff allowing plaintiff such a share; and since plaintiff's dual management failed to seek or make it, a court of equity will see that equity be done by awarding judgment to plaintiff for its fair share of the tax savings.

C

Defendant's arguments disputing the propriety of a tax adjustment between plaintiff and defendant are unsound.

In the Court below defendant advanced various arguments against our position. We turn to answering those appearing most important.

1. *The alleged illegality of a tax adjustment agreement.*

Defendant contended below that it could not have agreed to pay plaintiff a share of the tax savings; for such an agreement would have been tantamount to a merchandising of tax advantages and would have been illegal.

If the argument were valid, the agreements approved by the S. E. C. in the two last quoted cases and in several others* would have been illegal. Equally illegal would

* *Matter of Consolidated Electric & Gas Co. (The Islands Gas & Electric Co.)*, 13 S. E. C. 649 (1943); *Matter of Ogden Corporation* (S. E. C. Holding Company Act Release No. 5904, July 23, 1945); *Matter of United Public Utility Corporation* (S. E. C. Holding Company Act Release No. 6301, December 31, 1945).

be the Commission's Rule U-45(b)(6) which requires affiliated utility companies to enter into tax adjustment contracts in accordance with the formula prescribed by the Commission. But actually, no provision of law requires that tax savings—unlike any other savings—must remain where they happen to fall, even if they fall in the wrong pocketbook.

The error of defendant's argument is easily demonstrated: Agreements between affiliated corporations for the allocation of tax burdens and tax benefits among themselves are expressly sanctioned by statute and Treasury regulation.

(a) Originally the subject of inter-company tax allocation was covered by the statute itself. § 142(b) of the Internal Revenue Act of 1918 provided that a consolidated tax shall be assessed upon the respective affiliated corporations "in such proportions as may be agreed upon among them".* Allocation agreements made under this provision were binding not only among the parties, but even on the Commissioner who could collect from each affiliated corporation only such share of the consolidated tax as it had agreed to assume.

Since this statutory scheme made the collection of consolidated taxes unduly difficult, it was abandoned by the 1928 amendment of the Revenue Act which authorized the Commissioner of Internal Revenue to make appropriate regulations governing the subject; Internal Revenue Code, § 141(b). Pursuant to this authorization, the Commissioner promulgated Treas. Reg. 104, § 23.15, which provided:

"(a) Several Liability of Members of Affiliated Group.

* "In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or in the absence of any such agreement, then on the basis of the net income properly assignable to each. * * *" (§ 142(b) of the Internal Revenue Act of 1918).

"Except as provided in paragraph (b), a common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group.

* * * * *

"(d) Effect of Inter-company Agreements.

"Any agreement entered into by one or more members of the affiliated group with any other members of such group or with any other person shall in no case have the effect of reducing the liability prescribed under this section."

This regulation thus had a threefold effect: It made each group member severally liable to the Government for the entire tax; this liability to the Government could not be impaired by an inter-company agreement; but as between the members of the group the validity of inter-company agreements for the allocation of tax burdens or tax benefits was recognized. Unquestionably, therefore, an agreement between plaintiff and defendant, allowing plaintiff a share in the tax savings of defendant, would have been legal.

(b) The so-called "merchandising of tax advantages"—condemned in cases such as *Gregory v. Helvering*, 273 U. S. 465 (1935), and *Higgins v. Smith*, 308 U. S. 473 (1940), more recently also by Internal Revenue Code, § 129—relates to altogether different situations. They involve attempts of taxpayers to escape their normal tax liability to the Government by distorting their transactions through the artificial interposition of a newly organized or acquired corporation. By contrast, the tax adjustment agreement which, we say, should have been made between plaintiff and defendant would not have been designed to escape an otherwise existing tax liability. The agreement would have been effective only as between the parties; it would not have been designed to affect the Government's right to assess any taxes due it; and it would not have involved the artificial distortion of an otherwise taxable transaction.

The doctrine forbidding the merchandising of tax advantages is, therefore, beside the point.

(c) Defendant contends that tax saving payments, even though not illegal, have met with administrative condemnation. But there, too, the fact situation was quite different from that at bar.

Defendant relies on a report of the Federal Trade Commission * which was rendered before the enactment of the Public Utility Holding Company Act of 1935 (15 U. S. C. §§ 79 et seq.). The report relates that it was a not uncommon practice for public utility holding companies to pay taxes for their groups on a consolidated return basis, while collecting from their operating subsidiaries contributions in amounts equal to the taxes which each subsidiary would have had to pay on a separate basis; the difference was retained by the parent. The result was to increase the operating expenses of the subsidiaries; and, in consequence, the public was charged higher rates for electricity and gas. The practice was criticized on this ground by the F. T. C., which recommended, in the interest of the "protection of the rate-paying public", an amendment of the tax laws prohibiting such arrangements (Report, pp. 69-70). Plainly, the Commission's criticism is inapplicable to non-utility companies such as the present parties; and it has nothing to do with extraordinary fact situations such as that at bar, where the economic unity of parent and subsidiary has been destroyed, so that the intended automatic upstream flow of the tax savings to the parent is prevented.

The F. T. C.'s recommendation was not adopted by Congress. Instead, Congress enacted the Public Utility Holding Company Act which left the subject matter for regulation by the Securities and Exchange Commission. The S. E. C., in turn, adopted its Rule U-45(b)(6); and under

* Federal Trade Commission, Summary Report to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.

this rule, as we have seen, the Commission repeatedly allowed tax saving payments in the interest of fairness because of the presence of extraordinary circumstances similar to those at bar.

We submit that, in the circumstances here present, an agreement by defendant to allow plaintiff a fair share of its tax savings would have been altogether legal; and that no grounds of public policy would have opposed such an agreement.

2. Absence of detriment to plaintiff.

Another argument of defendant urges that defendant's use of plaintiff's tax credit caused plaintiff no injury. For in none of the years involved did plaintiff have taxable income against which it could have offset its tax credit; hence plaintiff suffered no detriment through the use of its tax credit by defendant.

This argument is crowded with fallacies.

(a) To begin with, it does not meet the issue in this case. The issue here is whether it was fair for defendant to retain all the tax savings or whether in fairness it should have allowed plaintiff a share therein. Since by the very purpose of the tax laws the tax savings were designed for the benefit of plaintiff, plaintiff should have been given at least a fair share; and the denial of that share to plaintiff constituted plaintiff's detriment.

To illustrate: Suppose that a fiduciary manages two businesses, one belonging to himself, the other to his cestui. By combining the purchasing power of the two, he buys merchandise at prices cheaper than each business would have had to pay separately. Manifestly it would be unfair for the fiduciary to keep the whole price saving for himself. The cestui is entitled to a fair share of the saving; and this right cannot be defeated by the argument that the cestui is not damaged because, buying separately, he could not have achieved the saving.

Fairness or unfairness are thus the test of recovery herein; detriment to plaintiff is inherent in any finding that it was treated unfairly.

(b) In any event, detriment or injury to plaintiff is no prerequisite to recovery by plaintiff. For defendant, in its dealings with plaintiff, was subject to the duties of a fiduciary; and, under elementary rules, a fiduciary deriving profit from a transaction conducted by him as such is accountable to the cestui for the profit, although the cestui has suffered no loss or injury.

The basic rule is set forth in the *Restatement of Restitution* (1937), § 1, Comment e, pp. 14-15:

“So, also, where a person in a fiduciary relation to another makes a profit in connection with transactions conducted by him as fiduciary, he is ordinarily accountable to his beneficiary for the profit, although the beneficiary suffered no loss (see *Restatement of Agency*, § 388, and *Restatement of Trusts*, § 203).”

Indeed, it must be so; for the fiduciary rule

“is not based on harm done to the beneficiary in the particular case, but rests on a broad principle of preventing a conflict of opposing interests in the minds of fiduciaries, whose duty it is to act solely for the benefit of their beneficiaries.”

Restatement of Restitution, § 197, Comment c, pp. 809-810.

This Court, in *Fleishhacker v. Blum*, 109 F. 2d 543, 546 (C. C. A. 9, 1940), cert. den. 311 U. S. 665, recognized the same rule by holding a bank officer accountable for the breach of his fiduciary duty,

“even though the bank has suffered no damage (*Restatement, Restitution*, § 197, Comment c).”

Direct authorities on the point are the *Shreveport Bank* cases (*supra*, p. 35). There, it will be recalled, the "new bank" had derived tax savings from the fact that it was the technical legal owner of certain real estate which equitably belonged to the "old bank". The new bank's procurement of these tax savings caused no detriment whatever to the old. Nevertheless, the courts held that the new bank, as a fiduciary of the old, must account to the latter for its tax savings:

"There can be little question but what the relation of the new Bank to the old * * * was one requiring the utmost good faith and constituted it an agent, trustee or fiduciary. * * * It could not profit therefrom in any manner other than as provided by the contract, * * *. If the transaction involved in this case had been between individuals, or if the stock could have been taxed directly to the [new] Bank, and he or it had used the value of the property standing in his or its name for personal profit by having the taxes reduced, he or it would have been bound to account to the principal for such profit regardless of whether the principal had suffered injury or not. 3 C. J. S., Agency, § 165, page 54."

(28 F. Supp., at 933)

Just as the defendant in the *Shreveport Bank* cases was held accountable for its tax saving, even though it had caused no loss or detriment to the plaintiff, so, in the case at bar, the alleged absence of injury to plaintiff does not relieve defendant from allowing plaintiff at least a fair share of the tax savings secured by the use of plaintiff's tax credit.

(c) We have assumed so far that defendant's use of plaintiff's tax credit caused plaintiff no injury. But even that premise of defendant's argument cannot stand.

Whether or not plaintiff's tax credit was a thing of value must be determined as of the time defendant appropriated

it. The first appropriation occurred on July 15, 1944, the date on which the consolidated returns for 1943 were filed. At that time it was still possible that plaintiff might have taxable income of its own in the latter part of 1944 and 1945; and plaintiff's tax credit could be carried forward to offset any such taxable income. While it is true that the possibility of future income did not materialize, that is hindsight and irrelevant. Plaintiff's tax credit, when appropriated by defendant, was a thing of value; its diversion necessarily injured plaintiff.

A second reason likewise demonstrates the value of plaintiff's tax credit. Even if plaintiff could not use it, defendant could. The very fact that plaintiff's tax credit was useful to defendant made it a valuable asset.

Defendant's argument that plaintiff's tax credit was worthless because plaintiff had no direct use for it, is tantamount to saying that, if I own the right shoe of a pair and you own the left, I may appropriate your shoe and you will not be injured; because, forsooth, the left shoe alone was useless to you. Such reasoning would hardly be persuasive.

The present case is comparable. Defendant could not save its taxes without using plaintiff's tax credit. Plaintiff, in turn, could not have utilized its tax credit except by offsetting it against defendant's income. Both defendant's taxable income and plaintiff's tax credit were necessary elements to achieve the tax saving, just as both the right shoe and the left shoe were necessary to make a useful garment. The only difference is that plaintiff's tax credit here was created for the very purpose of conferring a tax saving on plaintiff in order to mitigate its stock loss; not to confer an undeserved and unmotivated tax advantage on defendant; so that it might well be argued that plaintiff is entitled to a greater share of the tax savings than defendant.

A close analogy to this aspect of our case is furnished by *Truncale v. Universal Pictures Co.*, *supra* (76 F. Supp. 465). As previously stated, a corporation there was caused

by its directors to waive its right to a certain tax deduction; this enabled the directors to save their private taxes in an amount substantially exceeding the corporation's tax detriment. The question arose whether the corporation could recover only the amount of its tax detriment or, on top of that, the tax savings of the directors. The court decided for the latter alternative; for

"where a corporation has the freedom to do an act or to refrain, the doing of the act, enabling others to derive benefits in excess of the loss suffered by the corporation, has a 'sale' value of which the ceiling is the amount of such benefits * * *" (76 F. Supp., at 469).

By the same token the present plaintiff had the freedom to make its tax credit available to defendant or to refrain from doing so. Hence, the "doing of the act", i. e., making the tax credit available to defendant, had a "sale value" of which the ceiling was the amount of defendant's benefit, i. e., defendant's tax saving.

3. *An attempted reductio ad absurdum of our position.*

Defendant has depicted horrible consequences which would follow from the allowance of our claim. If plaintiff be entitled to share in defendant's tax savings, then, according to defendant, every corporation making its tax credit available to an affiliate would have the same right. Every consolidated tax return filed by an affiliated group of corporations would give rise to innumerable controversies between the "loss companies" and the "income companies".

Defendant's apprehensions are unfounded. A recovery by plaintiff under the unique facts of this case would have none of the far-reaching implications projected by defendant.

(a) The unique or, as defendant put it (R. 512), "unusual" character of this case grows from the combination

of two factors: The cataclysmic nature of plaintiff's loss; and the filing of consolidated returns by corporations nominally affiliated, but actually total strangers. Each of these factors gives rise to equities in plaintiff's favor. Plaintiff's loss cried for mitigation; the tax laws were designed to give it; but the total economic severance of the parties prevented it. Plaintiff's case derives its strength from this extraordinary congery of events, each unusual by itself.

(b) No comparable equities exist under normal circumstances. Normally consolidated returns are filed by an affiliated group constituting an economic unit, owned by a "common owner"; this, indeed, is the "presumption on which the right [to file consolidated returns] is made to rest" (*Duke Power* case, *supra*, 44 F. 2d, at 545). The economic unity may not be complete; the rights of creditors or minority stockholders of a subsidiary may dilute it; still, by and large, the parent will be the ultimate owner of the assets of each subsidiary, will suffer from its losses and will automatically benefit from its tax savings.

In such a unified group, there will be little basis to support claims for tax saving payments. Thus if the parent company of the group sustains a loss and one of its subsidiaries is profitable, the subsidiary's tax saving automatically benefits the parent (by enhancing the value of the parent's stock in the subsidiary); the purpose of the tax laws is thereby achieved; and with that purpose achieved, there will, as a rule, be no ground in equity to compel a tax saving payment.

Conversely, if the parent has a profit and one of its subsidiaries a loss, a tax saving payment by the parent to the subsidiary would be contrary to the purpose of the consolidated return statute; for that statute is designed for the parent's benefit, not the subsidiary's.

It follows that in the ordinary situation of an affiliated group constituting an economic unit there will hardly, if ever, exist any basis for tax saving claims. As stated by

the S. E. C. in *Matter of Cities Service Company* (*supra*, p. 47):

“ * * * in the ordinary case the fact that one subsidiary contributes a particular income deduction to a consolidated return does not in itself entitle that subsidiary to the benefits of the reduced taxes resulting from the deduction.”

The allowance of plaintiff's claim, based upon the extraordinary facts at bar, would therefore not mean the allowance of similar claims in the absence of such extraordinary circumstances. Defendant's pretended concern that the decision herein will furnish a rule applicable to all affiliated groups filing consolidated returns is misplaced.

We submit that, in the circumstances of this case, nothing in the tax laws justifies the retention by defendant of its undeserved tax savings; and that fairness and the purpose of the tax laws required defendant to allow plaintiff at least a substantial share of the tax benefits derived from plaintiff's tax credit. And since defendant, as a fiduciary, was required to deal fairly with plaintiff, equity should direct defendant to do now what it should have done long ago, namely, to pay at least a substantial part of its tax savings to plaintiff.

POINT III

The grounds upon which the District Court dismissed the action were erroneous.

The District Court predicated dismissal upon three grounds which we shall discuss in order:

1. It thought that defendant's tax saving improperly deprived the Government of taxes due it and that this injustice should not be compounded by distributing defendant's illegal gain to others (*A, infra*):

2. It conceived plaintiff's claim as an attempt by plaintiff to secure part of defendant's income in contravention of its reorganization plan (B, *infra*); and

3. It intimated that plaintiff was under a firm obligation to save defendant's taxes by filing consolidated returns (C, *infra*).

A

Plaintiff's alleged inability to recover because of the injustice of defendant's tax saving.

We submit that this ground of the decision below cannot stand, for several reasons.

1. *The Government had no tax claim.*

It would seem unquestionable that plaintiff's stock loss fell within the definition of § 23(g) (4). If, for instance, plaintiff had realized taxable operating income in 1943, no one would doubt that such income could have been offset by plaintiff's stock loss.

Nor can it be denied that plaintiff and defendant were affiliates within the purview of § 141(a), entitled to file consolidated returns. The fact that defendant's stock held by plaintiff had become worthless, was no obstacle to consolidated returns, as is demonstrated by cases such as

Burnet v. Aluminum Goods Mfg. Co., 287 U. S. 544 (1932);

George A. Fuller Co. v. Commissioner, 92 F. 2d 72 (C. C. A. 2, 1937);

Trinity Buildings Corp. v. Commissioner, 40 B. T. A. 1315 (1939).

The two latter cases are fully discussed in plaintiff's brief. In the *Aluminum Goods* case, *supra*, the taxpayer had filed a consolidated return for the year 1917 covering itself and a subsidiary. The subsidiary had long been

insolvent, was liquidated in 1917 and dissolved in early 1918. The taxpayer claimed the loss of its investment in the subsidiary as a deduction for 1917. The Commissioner disallowed the deduction on the ground that it arose from an "inter-company transaction" between affiliated corporations, which must be ignored in a consolidated return. The Circuit Court of Appeals overruled the Commissioner because it thought that the subsidiary's insolvency and liquidation had *de facto* terminated the affiliation, although the parent still held title to the subsidiary's stock; "it would be a legal and commercial impossibility for a going corporation to affiliate with a corpse", *Aluminum Goods Mfg. Co. v. Commissioner*, 56 F. 2d 568, 571 (C. C. A. 7, 1932). But the Supreme Court, although affirming on other grounds, disapproved specifically the Circuit Court's reasoning and held that "since complete stock ownership is made the test of affiliation applicable here * * *, no ground is apparent for saying that the corporations ceased to be affiliated * * *" (287 U. S., at 548). Stock ownership as such, although economically worthless, was thus recognized as the statutory test of "affiliation"; and it was so recognized although the Supreme Court was aware that "the purpose of requiring consolidated returns" was to effectuate the affiliated group's status as "a single business enterprise" (287 U. S., at 547).

The *Aluminum Goods* case is significant for an additional reason: The taxpayer there, like the plaintiff here, used as a tax deduction the loss of the very stock which, at the same time, it used as a basis for establishing affiliation. The allowance of the deduction there was certainly no less "paradoxical" than the allowance of the similar deduction in the case at bar.

We submit, therefore, that, so far as the Government is concerned, there existed a substantial basis for the non-payment of taxes for 1942-1944.

Indeed, the analysis here presented was not questioned by the Commissioner of Internal Revenue.* The District Court, nevertheless, rejected it as "plain stupidity" (R. 270); but the Court failed to assign any reason for this criticism and we believe that it was wholly unwarranted.

In any event, there is no need, at this late stage, to decide the question of tax liability *de novo*; for this question was settled between the Government and the parties. For present purposes it is enough to show a reasonable basis for the parties' claim that no taxes were due.

2. The Government's tax claim has been validly and properly settled.

Confronted with a substantial tax controversy, the Commissioner of Internal Revenue was certainly within his rights in consenting to a settlement. The District Court's suggestion that he "would not hesitate to set aside the tax settlement" if he had the power (R. 270), appears therefore gratuitous.

It is even more so because of the complete absence of any ground to impugn the legality or propriety of the settlement. The District Court did not find that the settlement was reached through fraud or corruption; and there is not

* The Commissioner merely contended that plaintiff's loss had occurred in 1940, so that it was inadmissible as a deduction for the years 1942-1944 (R. 1423-4). But tax counsel argued persuasively that plaintiff's loss had not been ascertained until the Supreme Court's decision of March 15, 1943 (Pl. Ex. 64, R. 1779).

The Court below professed not to understand "how the alleged uncertainty as to the date of ascertainment of the stock loss could have been a true factor affecting the tax settlement, inasmuch as any such uncertainty would, if it existed, as well apply with respect to the 1943 and 1944 returns" (R. 267, fn. 8). Of course, it is true that the "uncertainty" applied to each of the years 1942, 1943 and 1944. Just because of this uncertainty the entire \$21,000,000 tax amount for the three years was in controversy; and this controversy was ultimately compromised by the Government's retaining the \$4,000,000 which it had already received and defendant's retaining the balance of \$17,000,000. We fail to see how this arrangement could strike the Court below as implausible.

a shred of evidence which would support such finding. "The presumption of regularity supports the official acts of public officers and, in the absence of clear evidence to the contrary, courts presume that they have properly discharged their official duties"; *United States v. Chemical Foundation*, 272 U. S. 1, 14-15 (1926). This presumption, totally un rebutted here, is the answer to the District Court's unwarranted attack upon the settlement.

3. *Even if the tax settlement had been a wrong against the Government, it would not defeat plaintiff's rights.*

A hypothetical case will serve to make our point. Suppose that the executor of an estate, by improper means, collects an unjust claim of the estate or evades the payment of estate taxes justly due. Will it be suggested that he may retain the fruits of his illegal acts for himself? We believe that he would be accountable to his beneficiary for all profits derived in the course of his conduct as executor and that he cannot escape accountability by invoking his own wrongdoing. The present defendant, by virtue of its fiduciary duties to plaintiff, occupies no different position.

Indeed, the *Shreveport Bank* cases (*supra*, p. 35) so hold. There the procurement of the tax savings by the "new bank" constituted a plain wrong to the State of Louisiana. Nevertheless, the new bank was required to account for those tax savings to the old bank: and even Judge Waller, who originally dissented because the State had been "gypped" (144 F. 2d, at 245), subsequently joined the majority in permitting recovery of those tax savings which the new bank had secured for itself in the conduct of its fiduciary duties (176 F. 2d, at 1007-8, 1012-13).

4. *The District Court's pre-trial order, approving the parties' pre-trial stipulation, permits plaintiff to obtain at least the 1942 tax moneys.*

Even on the violent assumptions that the origin of defendant's tax savings was tainted and that the Court must

therefore "leave the parties where they are" (R. 276), it does not follow that plaintiff takes nothing. For purposes of this litigation, the 1942 tax moneys must be deemed in the possession of plaintiff; this is the basis upon which, under the parties' pre-trial stipulation and the District Court's pre-trial order (R. 163, 168), the case must be decided; hence, in order to "leave the parties where they are" or, more accurately, where they are deemed to be, plaintiff must be given the 1942 tax savings.

The origin and nature of the pre-trial stipulation and order have been previously described (*supra*, pp. 23-24, 25). Their substance is that this litigation shall be decided as though plaintiff's \$4,201,821.54 refund claim (reduced by 4/21 thereof) had been allowed and paid by the Government to plaintiff. In other words, plaintiff is entitled, for purposes of the decision of this litigation, to be treated as though it had possession of \$3,401,474.58 of the tax moneys in controversy. If the District Court felt impelled to "leave the parties where they are", it should at least have given effect to its own pre-trial order by putting plaintiff in possession of the 1942 tax moneys and then leaving the parties where they were.

B

The alleged inconsistency of plaintiff's claim with defendant's reorganization plan.

The District Court's reasoning runs: A "saving" in taxes actually means earnings not paid out to the Government. Plaintiff's claim is therefore a demand for a share of defendant's earnings; and the assertion by plaintiff of such a claim "is a circuitous way of obtaining something in the nature of equity or value for its ownership [of defendant's stock], rejected in the reorganization plan" (R. 272-4).

The fallacy of this reasoning lies in the confusion of what plaintiff is entitled to get by virtue of its stock ownership in defendant; and what it is entitled to get by virtue of defendant's use of plaintiff's tax credit.

It is perfectly true that defendant's reorganization plan precluded plaintiff from any share in defendant's assets or earnings based upon plaintiff's ownership of stock in defendant. That stock was wiped out by defendant's reorganization plan; and plaintiff was left, at this point, without right or interest in defendant's assets and earnings.

But after this was done—indeed, because it was done—plaintiff had a tax credit. The tax credit belonged to plaintiff; it did not belong to defendant. Defendant's reorganization plan, and the orders approving and confirming it, may be searched from A to Z; no breath of a suggestion will be found that plaintiff's tax credit must be made available to defendant.*

Plaintiff did make its tax credit available to defendant; defendant caused it to do so. This was a new transaction not contemplated by the reorganization plan. Plaintiff's claim stems from this new transaction; for, we say, plaintiff was in fairness entitled to the benefits from defendant's use of plaintiff's tax credit. By no stretch of argument may plaintiff's claim be viewed as based on its previous stock ownership in defendant.

Indeed, this is graphically demonstrated by the sequence of events. The consolidated returns and the refund claim were filed between July 15, 1944 and June 15, 1945. Prior to any of these dates—on April 30, 1944—plaintiff had surrendered its stock in defendant to the reorganization committee. Plaintiff was therefore no longer a stockholder of defendant at the time the tax returns and the refund claim were filed. Whatever rights plaintiff has in connection with these events, they cannot stem from its stock ownership in defendant which, at that time, was nonexistent. It follows that plaintiff's present claim, based upon the use of its tax credit by defendant, does not contravene the provisions of the reorganization plan eliminating plaintiff's stock interest in defendant.

* The plan could contain no such suggestion. It was formulated in 1939 and approved in 1940 (R. 259). But the statutory amendment which made the tax credit possible—Internal Revenue Code, § 23(g) (4)—was not enacted until 1942.

C

**Plaintiff's alleged obligation to save defendant's taxes
by filing consolidated returns.**

The District Court did not state the ground upon which it considered plaintiff obligated to file consolidated returns so as to save defendant's taxes (R. 275). Defendant itself advanced two reasons.

1. *Plaintiff's alleged fiduciary duty to defendant.*

In the first place, defendant said that plaintiff owned all of defendant's stock; that this stock ownership placed upon plaintiff a fiduciary duty to safeguard defendant against detriment; and that plaintiff would have violated this fiduciary obligation by refusing to join in consolidated returns which would minimize defendant's taxes.

Premise and conclusion of this argument are equally faulty.

(a) To begin with, plaintiff was no longer a stockholder of defendant during the critical period from July 1944 to June 1945; it had surrendered the stock in April 1944. Moreover control, rather than stock ownership, has been held to be the basis of fiduciary obligations (*Southern Pacific Co. v. Bogert, supra*, 250 U. S., at 492); and plaintiff certainly had no control of defendant or its court-appointed trustees. On both counts defendant's argument to establish fiduciary duties of plaintiff is untenable.

(b) But even if plaintiff had been a fiduciary, it was under no obligation to file consolidated returns and make its tax credit available to defendant. The tax credit, as we have shown (*supra*, pp. 55-57), was a thing of value. A fiduciary is held to the highest standards of honesty in dealing with his cestui; but he certainly is not required to donate his own property to the cestui. Plaintiff's tax credit was its own, not defendant's; and if plaintiff

“decided that its best interests required filing by it of a separate tax return, no provision of the law denied it this privilege * * *.”

Duke Power Co. v. Commissioner, supra, 44 F. 2d, at 545.

Moreover, by filing consolidated returns plaintiff subjected itself to joint and several liability for any taxes or tax deficiencies which might be assessed on defendant's income (Treas. Reg. 104, § 23.15(d)). It is not a fiduciary's duty to make himself the surety for his cestui's tax obligations.

(c) In any event, if plaintiff was under a fiduciary duty to defendant, defendant was under no less an obligation to plaintiff. The duality of management and defendant's control of the tax transactions created this obligation. Defendant's argument thus leads, at most, to the conclusion that both parties were required to deal fairly with each other. Nowhere has defendant shown that fair dealing permitted it to retain the tax savings derived from plaintiff's tax credit. On the contrary, in the light of the purpose of the tax laws to mitigate plaintiff's stock loss and to benefit it as the parent of the affiliated group, fairness entitled plaintiff at least to a fair share of the tax savings produced by the joint action of the parties.

2. *Plaintiff's alleged obligation under the bankruptcy laws.*

Defendant's second argument is predicated upon its bankruptcy reorganization. Defendant, as the debtor in reorganization, was obligated to preserve its assets for the benefit of creditors. Plaintiff, as its stockholder, was under the same duty by virtue of § 7(b) of the Bankruptcy Act, 11 U. S. C. § 25(b). From this obligation defendant concludes that plaintiff was required to preserve defendant's estate by minimizing its tax through the filing of consolidated returns.

(a) Again this argument overlooks that, at the time the consolidated returns and the refund claim were filed, plaintiff was no longer a stockholder of defendant. § 7(b) of the Bankruptcy Act was therefore inapplicable; hence defendant's bankruptcy imposed no duty on plaintiff to preserve defendant's assets.

(b) Again, even if it were assumed that plaintiff was under an obligation to preserve defendant's assets because of its bankruptcy, yet certainly plaintiff was under no duty to donate its tax credit to defendant. It is true that plaintiff's tax credit could be of great value to defendant; but does it follow that plaintiff was obligated to make a gift of it to defendant? If plaintiff had been the owner, say, of rolling stock useful to defendant, no one would argue that defendant's need, or its bankruptcy, created an obligation of plaintiff to donate its property to defendant. No better ground exists for defendant's contention that plaintiff was obligated, because of defendant's bankruptcy, to donate its tax credit to defendant and, on top of that, by joining in consolidated returns, to make itself jointly and severally liable for defendant's tax debts.

(c) Furthermore, any obligation on plaintiff's part to preserve defendant's assets did not include the duty to confer upon defendant a tax saving which, by the very purpose of the tax laws was designed for plaintiff, not for defendant. The purpose of the tax laws was to mitigate plaintiff's stock loss, not to give defendant an undeserved and unmotivated tax advantage; and this statutory purpose was not changed by defendant's bankruptcy.

(d) Finally, it might be noted that the 1944 returns and the 1942 refund claim were filed in 1945, long after defendant had emerged from reorganization. No argument based on defendant's bankruptcy can apply to transactions made after the bankruptcy had ended.

We submit that the decision below cannot be sustained because of the alleged obligation of plaintiff to join in consolidated returns.

Conclusion

It is respectfully submitted that the judgment of the District Court should be reversed and that this Court should grant judgment for plaintiff in the amount of defendant's tax savings or, at least, of such part thereof as to this Court may appear fair in the circumstances of this case.

Dated: San Francisco, Calif., September 14, 1950.

Respectfully submitted,

WILLIAM E. HAUDEK,
JULIUS LEVY,
WEBSTER V. CLARK,
Rogers & Clark,
111 Sutter Building,
San Francisco 4, Calif.

Pomerantz Levy Schreiber & Haudek,
295 Madison Avenue,
New York 17, N. Y.

David Friedenrich,
Balfour Building,
San Francisco 4, Calif.

Attorneys for Plaintiffs-
Intervenors-Appellants.

APPENDIX

TEXT OF STATUTES AND REGULATIONS CITED

Bankruptcy Act, § 7, 11 U. S. C., § 25

DUTIES OF BANKRUPTS

a. The bankrupt shall (1) attend at the first meeting of his creditors, at the hearing upon objections, if any, to his application for a discharge and at such other times as the court shall order; (2) comply with all lawful orders of the court; (3) examine and report to his trustee concerning the correctness of all proofs of claim filed against his estate; (4) execute and deliver such papers as shall be ordered by the court; (5) execute and deliver to his trustee transfers of all his property in foreign countries; (6) immediately inform his trustee of any attempt by his creditors or other persons to evade the provisions of this title coming to his knowledge; (7) in case of any person having to his knowledge proved a false claim against his estate, disclose that fact immediately to his trustee; (8) prepare, make oath to, and file in court within five days after adjudication, if an involuntary bankrupt, and with his petition, if a voluntary bankrupt, a schedule of his property, showing the amount and kind of property, the location thereof and its money value, in detail; and a list of all his creditors, including all persons asserting contingent, unliquidated, or disputed claims, showing their residence, if known, or if unknown that fact to be stated, the amount due to or claimed by each of them, the consideration thereof, the security held by them, if any, and what claims, if any, are contingent, unliquidated, or disputed; and a claim for such exemptions as he may be entitled to; all in triplicate, one copy for the clerk, one for the referee, and one for the trustee: *Provided*, That the court may for cause shown grant further time for the filing of such schedules if, with his petition in a voluntary proceeding or with his applica-

tion to have such time extended in an involuntary proceeding, the bankrupt files a list of all such creditors and their addresses; (9) file in triplicate with the court at least five days prior to the first meeting of his creditors a statement of his affairs in such form as may be prescribed by the Supreme Court; (10) at the first meeting of his creditors, at the hearing upon objections, if any, to his discharge and at such other times as the court shall order, submit to an examination concerning the conducting of his business, the cause of his bankruptcy, his dealings with his creditors and other persons, the amount, kind, and whereabouts of his property, and, in addition, all matters which may affect the administration and settlement of his estate or the granting of his discharge; but no testimony given by him shall be offered in evidence against him in any criminal proceeding, except such testimony as may be given by him in the hearing upon objections to his discharge: *Provided, however,* That when the bankrupt is required to attend for examination, except at the first meeting and at the hearing upon objections, if any, to his discharge, he shall be paid actual and necessary traveling expenses for any distance in excess of one hundred miles from his place of residence at the date of bankruptcy: *And provided further,* That the court may for cause shown, and upon such terms and conditions as the court may impose, permit the bankrupt to be examined at such place as the court may direct whether within or without the district in which the proceedings are pending; and (11) when required by the court, prepare, verify, and file with the court in duplicate a detailed inventory, showing the cost to him of his merchandise or of such other property as may be designated, as of the date of his bankruptcy.

b. Where the bankrupt is a corporation, its officers, the members of its board of directors or trustees or of other similar controlling bodies, its stockholders or members, or such of them as may be designated by the court, shall perform the duties imposed upon the bankrupt by this title.

Internal Revenue Code

§ 23. *Deductions from gross income.* In computing net income there shall be allowed as deductions: * * *

(g) Capital losses.

(1) Limitation. Losses from sales or exchanges of capital assets shall be allowed only to the extent provided in section 117.

(2) Securities becoming worthless. If any securities (as defined in paragraph (3) of this subsection) become worthless during the taxable year and are capital assets, the loss resulting therefrom shall, for the purposes of this chapter, be considered as a loss from the sale or exchange, on the last day of such taxable year, of capital assets.

(3) Definition of securities. As used in paragraph (2) of subsection the term "securities" means (A) shares of stock in a corporation, and (B) rights to subscribe for or to receive such shares.

(4) Stock in affiliated corporation. For the purposes of paragraph (2) stock in a corporation affiliated with the taxpayer shall not be deemed a capital asset. For the purposes of this paragraph a corporation shall be deemed to be affiliated with the taxpayer only if:

(A) at least 95 per centum of each class of its stock is owned directly by the taxpayer; and

(B) more than 90 per centum of the aggregate of its gross incomes for all taxable years has been from sources other than royalties, rents (except rents derived from rental of properties to employees of the company in the ordinary course of its operating business), dividends, interest (except interest received on deferred purchase price of operating assets sold), annuities, or gains from sales or exchanges of stocks and securities; and

(C) the taxpayer is a domestic corporation.

§ 122. Net operating loss deduction

(a) Definition of net operating loss. As used in this section, the term "net operating loss" means the excess of the deductions allowed by this chapter over the gross income, with the exceptions, additions, and limitations provided in subsection (d).

(b) Amount of carry-back and carry-over.

(1) Net operating loss carry-back. If for any taxable year beginning after December 31, 1941, the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-back for each of the two preceding taxable years, except that the carry-back in the case of the first preceding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the second preceding taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such second preceding taxable year without regard to such net operating loss.

(2) Net operating loss carry-over. If for any taxable year the taxpayer has a net operating loss, such net operating loss shall be a net operating loss carry-over for each of the two succeeding taxable years, except that the carry-over in the case of the second succeeding taxable year shall be the excess, if any, of the amount of such net operating loss over the net income for the intervening taxable year computed (A) with the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and (B) by determining the net operating loss deduction for such intervening taxable year without regard to such net operating loss and without regard to any net operating loss carry-back. For the purposes of the preceding sentence, the net operating loss for any taxable year beginning after December 31, 1941 shall be reduced by the sum of the net income for each of the two preceding taxable years (computed for each such preceding taxable year with

the exceptions, additions, and limitations provided in subsection (d) (1), (2), (4), and (6), and computed by determining the net operating loss deduction without regard to such net operating loss or to the net operating loss for the succeeding taxable year).

§ 129. Acquisitions made to evade or avoid income or excess profits tax

(a) Disallowance of deduction, credit, or allowance. If (1) any person or persons acquire, on or after October 8, 1940, directly or indirectly, control of a corporation, or (2) any corporation acquires, on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately prior to such acquisition, by such acquiring corporation or its stockholders, the basis of which property, in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation, and the principal purpose for which such acquisition was made is evasion or avoidance of Federal income or excess profits tax by securing the benefit of a deduction, credit, or other allowance which such person or corporation would not otherwise enjoy, then such deduction, credit, or other allowance shall not be allowed. For the purposes of clauses (1) and (2), control means the ownership of stock possessing at least 50 per centum of the total combined voting power of all classes of stock entitled to vote or at least 50 per centum of the total value of shares of all classes of stock of the corporation.

(b) Power of Commissioner to allow deduction, etc., in part. In any case to which subsection (a) is applicable the Commissioner is authorized—

(1) to allow as a deduction, credit, or allowance any part of any amount disallowed by such subsection, if he determines that such allowance will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(2) to distribute, apportion, or allocate gross income, and distribute, apportion, or allocate the deductions, credits, or allowances the benefit of which was sought to be secured, between or among the corporations, or properties, or parts thereof, involved, and to allow such deductions, credits, or allowances so distributed, apportioned, or allocated, but to give effect to such allowance only to such extent as he determines will not result in the evasion or avoidance of Federal income and excess profits tax for which the acquisition was made; or

(3) to exercise his powers in part under paragraph (1) and in part under paragraph (2).

§ 141. Consolidated returns

(a) Privilege to file consolidated income and excess-profits-tax returns. An affiliated group of corporations shall, subject to the provisions of this section, have the privilege of making consolidated income and excess-profits-tax returns for the taxable year in lieu of separate returns. The making of consolidated returns shall be upon the condition that the affiliated group shall make both a consolidated income-tax return and a consolidated excess-profits-tax return for the taxable year, and that all corporations which at any time during the taxable year have been members of the affiliated group making a consolidated income-tax return consent to all the consolidated income- and excess-profits-tax regulations prescribed under subsection (b) prior to the last day prescribed by law for the filing of such return. The making of a consolidated income-tax return shall be considered as such consent. In the case of a corporation which is a member of the affiliated group for a fractional part of the year, the consolidated returns shall include the income of such corporation for such part of the year as it is a member of the affiliated group. In the case of a corporation which is not a member of the affiliated group after March 31, 1942, of the last taxable year of such group which begins before April 1, 1942, such cor-

poration shall not be considered a member of the affiliated group for consolidated income-tax-return purposes for such year but shall be considered a member of such group for consolidated excess-profits-tax-return purposes for such year, and the consent required in the case of such corporation shall relate only to the consolidated excess-profits-tax regulations.

(b) Regulations. The Commissioner, with the approval of the Secretary, shall prescribe such regulations as he may deem necessary in order that the tax liability of any affiliated group of corporations making consolidated income- and excess-profits-tax returns and of each corporation in the group, both during and after the period of affiliation, may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability and the various factors necessary for the determination of such liability, and in order to prevent avoidance of such tax liability. Such regulations shall prescribe the amount of the net operating loss deduction of each member of* the group which is attributable to a deduction allowed for a taxable year beginning in 1941 on account of property considered as destroyed or seized under section 127 (relating to war losses), and the allowance of the amount so prescribed as a deduction in computing the net income of the group shall not be limited by the amount of the net income of such member.

(c) Computation and payment of tax. In any case in which consolidated income-tax and excess-profits-tax returns are made or are required to be made, the taxes shall be determined, computed, assessed, collected, and adjusted in accordance with the regulations under subsection (b) prescribed prior to the last day prescribed by law for the filing of such returns; except that the tax imposed under section 15 or section 204 shall be increased by 2 per centum of the consolidated corporation surtax net income of the affiliated group of includible corporations. Only one spe-

cific exemption of \$10,000 provided in section 710(b) (1) shall be allowed for the entire affiliated group of corporations for the purposes of the tax imposed by Subchapter E of Chapter 2.

(d) Definition of "affiliated group". As used in this section, an "affiliated group" means one or more chains of includible corporations connected through stock ownership with a common parent corporation which is an includible corporation if—

(1) Stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of each of the includible corporations (except the common parent corporation) is owned directly by one or more of the other includible corporations; and

(2) The common parent corporation owns directly stock possessing at least 95 per centum of the voting power of all classes of stock and at least 95 per centum of each class of the nonvoting stock of at least one of the other includible corporations.

As used in this subsection, the term "stock" does not include nonvoting stock which is limited and preferred as to dividends.

(e) Definition of "includible corporation". As used in this section, the term "includible corporation" means any corporation except—

(1) Corporations exempt under section 101 from the tax imposed by this chapter.

(2) Insurance companies subject to taxation under section 201 or 207.

(3) Foreign corporations.

(4) Corporations entitled to the benefits of section 251, by reason of receiving a large percentage of their income from sources within possessions of the United States.

(5) Corporations organized under the China Trade Act, 1922.

(6) Regulated investment companies subject to tax under Supplement Q.

(7) Any corporation described in section 725(a), or in section 727 (e), (g), or (h) (without regard to the exception in the initial clause of section 727) but not including such a corporation which has made and filed a consent, for the taxable year or any prior taxable year beginning after December 31, 1943, to be treated as an includible corporation. Such consent shall be made and filed at such time and in such manner as may be prescribed by the Commissioner with the approval of the Secretary.

(f) Includible insurance companies. Despite the provisions of paragraph (2) of subsection (e), two or more domestic insurance companies each of which is subject to taxation under the same section of this chapter shall be considered as includible corporations for the purpose of the application of subsection (d) to such insurance companies alone.

(g) Subsidiary formed to comply with foreign law. In the case of a domestic corporation owning or controlling, directly or indirectly, 100 per centum of the capital stock (exclusive of directors' qualifying shares) of a corporation organized under the laws of a contiguous foreign country and maintained solely for the purpose of complying with the laws of such country as to title and operation of property, such foreign corporation may, at the option of the domestic corporation, be treated for the purpose of this chapter and of Subchapter E of Chapter 2 as a domestic corporation.

(h) Suspension of running of statute of limitations. If a notice under section 272(a) in respect of a deficiency for any taxable year is mailed to a corporation, the suspension of the running of the statute of limitations, provided in section 277, shall apply in the case of corporations with

which such corporation made a consolidated return for such taxable year.

(i) Allocation of income and deductions. For allocation of income and deductions of related trades or businesses, see section 45.

Securities and Exchange Commission Rule U-45

(a) General provision.—No registered holding company or subsidiary company shall, directly or indirectly, lend or in any manner extend its credit to nor indemnify, nor make any donation or capital contribution to, any company in the same holding company system, except pursuant to a declaration notifying the Commission of the proposed transaction, which has become effective in accordance with the procedure specified in Rule U-23, and pursuant to the order of the Commission with respect to such declaration under the applicable provisions of the Act.

(b) Exceptions.—The following transactions shall be exempt from the declaration requirements of this rule:

* * * *

(6) A loan or extension of credit or an agreement of indemnity arising out of a consolidated tax return filed by a holding company (or other parent company) and its subsidiaries: Provided, That the top company in the group assumes primary responsibility for the payment of any tax liability involved, subject to the right to contribution from the several members of the group in an amount not exceeding as to any company that percentage of the sum of the normal tax, surtax, and an excess profits tax on a consolidated basis which the sum of the normal tax, surtax and excess profits tax of such company if paid on a separate return basis is of the aggregate amount of normal, surtax and excess profits taxes of the individual companies based upon separate returns. In each instance the amount

of excess profits tax shall be computed less the amount of the post-war refund. In computing each company's tax on a separate return basis, allowance shall be made for loss carry-over and other adjustments as if the company had always filed its tax return on a separate return basis. The amount of post-war refund bonds which the consolidated group will acquire (under Section 780 of the Internal Revenue Code) and the liability therefor shall be allocated to the several members of the group in the ratio that the post-war refund bonds each company would acquire on a separate return basis bears to the sum of the post-war refund bonds which all of the companies would acquire on the basis of separate tax returns.

Treasury Regulation 104

§ 23.12:

(a) A consolidated return shall be made on Form 1120 by the common parent corporation for the affiliated group. Such return shall be filed at the time and in the office of the collector of the district prescribed for the filing of a separate return by such corporation.

(b) Each subsidiary must prepare duplicate originals of Form 1122, consenting to these regulations and authorizing the common parent corporation to make a consolidated return on its behalf for the taxable year and authorizing the common parent (or, in the event of its failure, the Commissioner or the collector) to make a consolidated return on its behalf (as long as it remains a member of the affiliated group), for each year thereafter for which, under section 23.11 (a), the making of a consolidated return is required. One of such forms as prepared by each subsidiary shall be attached to the consolidated return, as a part thereof; and the other shall be filed, at or before the time the consolidated return is filed, in the office of the collector for the district prescribed for the filing of a separate re-

turn by such subsidiary. No such consent can be withdrawn or revoked at any time after the consolidated return is filed.

The filing of Form 1122 for a taxable year beginning after December 31, 1943, by a subsidiary which is either a personal service corporation as described in section 725(a) or a corporation described in section 727 (e), (g), or (h) shall constitute the making and filing of its consent to be treated as an includible corporation under section 141(e)(7).

If the common parent corporation is a personal service corporation as described in section 725(a) or a corporation described in section 727 (e), (g), or (h), the making and filing of the consolidated income tax return for a taxable year beginning after December 31, 1943, shall constitute the making and filing of its consent to be treated as an includible corporation under section 141(e)(7).

A corporation which consents to be treated as an includible corporation for a taxable year beginning after December 31, 1943, shall be treated as an includible corporation for all subsequent years, regardless of whether the affiliated group of which such corporation is a member during such subsequent years is the same as the affiliated group of which such corporation was a member when such consent was filed. No consent to be treated as an includible corporation under section 141(e)(7) can be withdrawn or revoked at any time after the consolidated return is filed for the first taxable year for which the consent is filed.

§ 23.15:

(a) Except as provided in paragraph (b), the common parent corporation and each subsidiary, a member of the affiliated group during any part of a consolidated return period, shall be severally liable for the tax (including any deficiency in respect thereof) computed upon the consolidated net income of the group.

(b) If, at the time of filing a consolidated return, one or more, but not all, of the members of the affiliated group are in bankruptcy under the laws of the United States or in receivership in any court of the United States or of any State, Territory, or the District of Columbia, then the liability under paragraph (a) of each such member of the group with respect to the period covered by such return shall not exceed such portion of the consolidated tax liability for such period as the several corporations included in the consolidated return may, subject to the approval of the Commissioner, agree upon, or, in the absence of such an agreement, an amount equal to its liability for such year computed as if a separate return had been filed.

(c) If a subsidiary has ceased to be a member of the affiliated group, its liability under paragraph (a) shall remain unchanged, except that if such cessation occurred prior to the date upon which any deficiency is assessed and resulted from a bona fide sale of stock for fair value, the Commissioner may, if he believes that the assessment or collection of the balance of the deficiency will not be jeopardized, make assessment and collection of such deficiency from such former subsidiary in an amount not exceeding the portion thereof allocable to it upon the basis of income used in the computations respectively of the normal tax and any surtaxes included in such deficiency.

(d) Any agreement entered into by one or more members of the affiliated group with any other members of such group or with any other person shall in no case have the effect of reducing the liability prescribed under this section.

§ 23.16:

(a) The common parent corporation shall be for all purposes, in respect of the tax for the taxable year for which a consolidated return is made or is required, the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation which during any part

of such year was a member of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent, and the mailing to the common parent shall be considered as a mailing to each such corporation; notice and demand for payment of taxes will be given only to the common parent, and such notice and demand shall be considered as a notice and demand to each such corporation; the common parent will file petitions and conduct proceedings before the Board of Tax Appeals, and any such petition shall be considered as having also been filed by each such corporation; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent and will discharge any liability of the Government in respect thereof to any such corporation; and the common parent in its name will give waivers, give bonds, and execute closing agreements, offers in compromise, and all other documents, and any waiver or bond so given, or agreement, offer in compromise, or any other document so executed, shall be considered as having also been given or executed by each such corporation. Notwithstanding the provisions of this paragraph, however, any notice of deficiency, in respect of the tax for a consolidated return period, will name each corporation which was a member of the affiliated group during any part of such period, and any assessment (whether of the original tax or of a deficiency) will be made in the name of each such corporation (but a failure to include the name of any such corporation will not affect the validity of the notice of deficiency or the assessment as to the other corporations); any notice and demand for payment will name each corporation which was a member of the affiliated group during any part of such period (but a failure to include the name of any such corporation will not affect the validity of the notice and demand as to the

other corporations); and any distraint (or warrant in respect thereof), any levy (or notice in respect thereof), any notice of a lien, or any other proceeding to collect the amount of any assessment, after the assessment has been made, will name the corporation from which such collection is to be made. The provisions of this paragraph shall apply whether or not a consolidated return is made for any subsequent year, and whether or not one or more subsidiaries have become or have ceased to be members of the group at any time. Notwithstanding the provisions of this paragraph, the Commissioner may, if he deems it advisable, deal directly with any member of the group in respect of its liability, in which event such member shall have full authority to act for itself.

No. 12,506

IN THE

United States
Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION
and ALEXIS I. DUP. BAYARD, Receiver,
Plaintiffs and Appellants,
and

MEREDITH H. METZGER, HENRY OFFERMAN and
J. S. FARLEE & CO., INC., a corporation,
Interveners and Appellants,
vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Defendants and Appellees.

Brief for Appellees

ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
WALKER LOWRY,
McCUTCHEN, THOMAS, MATTHEW,
GRIFFITHS & GREENE,
1500 Balfour Building,
San Francisco 4, California
*Attorneys for The Western Pacific
Railroad Company, et al.,*

Appellees;

EVERETT A. MATHEWS,
PILLSBURY, MADISON & SUTRO,
225 Bush Street,
San Francisco 4, California
A. DONALD MACKINNON,
MILBANK, TWEED, HOPE & HADLEY,
15 Broad Street,
New York 5, New York

FORBES D. SHAW,
WHITMAN, RANSOM, COULSON & GOETZ,
40 Wall Street,
New York 5, New York
*Attorneys for Western Realty Company,
Appellee.*

Dated: November 15, 1950

SUBJECT INDEX

	Page
STATEMENT OF THE CASE.....	1
THE FACTS.....	2
1. The Parties and Their History.....	2
2. The Reorganization.....	4
3. Taxes Prior to 1942.....	7
4. Taxes for 1942.....	7
5. Taxes for 1943.....	8
6. Taxes for 1944 and the 1942 Refund Claim.....	10
7. The Settlement with United States.....	11
8. This Litigation and the Opinion Below.....	12
9. The "Fact" Statements by Appellants.....	15
SUMMARY OF THE ARGUMENT.....	18
ARGUMENT	21
I. Appellants Have No Claim.....	21
A. Appellants Have No Claim Based on the Failure, if Any, to Pay Taxes Due the United States.....	22
B. Appellants Have No Claim Based on Unjust Enrichment, Fiduciary Obligations or Duality.....	24
1. Appellants Have Suffered No Wrong and Proved No Damage.....	24
2. Appellants Have No Unjust Enrichment Claim....	25
(i) Appellees Were Not "Enriched".....	25
(ii) Assuming an Enrichment, It Was Not Un- just to Appellants.....	27
(iii) Appellants' Unjust Enrichment Recovery Could Not in Any Event Exceed the Actual Loss to Them.....	29
3. Appellants Have No Claim Arising from Fiduciary Obligations	30
(i) The Corporation Was Charged with Fidu- ciary Obligations.....	30

	Page
(ii) The Position of the Corporation Was Not That of a Cestui Que Trust.....	32
4. Appellants Have No Claim on Account of Duality	36
(i) The Duality Doctrine Has No Application Here	36
(ii) Appellants Have No Claim Based on a Hypothetical Bargain.....	38
(iii) There Has Been No Unfairness to Appellants	41
5. Appellants' Authorities.....	42
6. Appellants Have No Special Claim to the 1942 "Tax Saving".....	46
C. Appellants Have No Claim Based on the Revenue Acts	48
II. The Decision Below Is in Accordance with All the Precedents, with General Business Practice and with the Special Equities of This Case.....	52
A. The Decision Below Is in Accordance with General Business Practice.....	52
B. The Decision Below Is in Accordance with All the Precedents	53
C. The Decision Below Is in Accordance with the Special Equities of This Case.....	58
1. The Circumstances of the Case Require That There Should Be No "Tax Saving" Payment to the Corporation.....	58
2. The alleged Severance of "Economic Unity" Affords No Reason for a Special Conclusion.....	60
D. The Decision Below Is in Accordance with Sound Policy	64
III. Appellants' Claim Is Inequitable.....	65
A. The Corporation Cannot in Equity Repudiate Retroactively the Tax Allocation Formula Followed by the Group for Twenty Years.....	65

	Page
B. The Corporation Cannot in Equity Deplete the Assets of Its Former Subsidiary at the Expense of Creditors Who Were Not Paid in Full.....	66
IV. Appellants' Claim Is Barred by the Failure to Present It During the Reorganization Proceeding and by the Final Orders of the Reorganization Court.....	68
A. Appellants' Claim Is Contrary to the Policy of Section 77 of the Bankruptcy Act and to the Purpose of the Western Pacific Reorganization.....	68
B. An Unauthorized and Unapproved Claim for Payment of an Administrative Expense Cannot be Enforced	72
1. A Court Trustee Can Incur No Liability Without Court Approval and Section 77 and the Orders in the Western Pacific Reorganization So Provide	72
2. This Court Has Specifically Held That Unapproved Claims for Administrative Expenses Cannot Be Enforced.....	74
3. The Assumption Agreement Does Not Provide for Payment of Appellants' Claims.....	75
C. Appellants' Claim Is Barred and Enjoined by the Final Orders of the Reorganization Proceeding.....	79
D. The Court Below Was Without Power to Modify Orders of the Reorganization Court.....	82
CONCLUSION	83

APPENDICES:

	App. Page
Appendix A Schedules of Directors and Officers, The Western Pacific Railroad Corporation, and Their Terms of Service.....	1
Appendix B	
I. Material from the Federal Trade Commission.....	2
A. Report of the Federal Trade Commission on Public Utility Holding Companies.....	2
II. Material from the Securities and Exchange Commission	7
A. Excerpts from Securities and Exchange Commission Release No. 53, Accounting Series.....	7
III. Material from the National Association of Railroad and Utilities Commissioners.....	14
A. Excerpts from the 1943 Report of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners.....	14
B. Excerpts from the 1945 Report of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners.....	15
IV. Material from the Treasury Department.....	17
A. I.T. 3637 (1944 Cumulative Bulletin 258).....	17
B. I.T. 3692 (1944 Cumulative Bulletin 261).....	21
C. Excerpt from T.D. 5086, Amendments to Regulations 103 (1941-2 Cumulative Bulletin 46).....	23
V. Tabulation of Congressional Material Relating to Consolidated Tax Returns.....	23
Chronology of Reorganization Proceedings and Chronology of Tax Returns and Related Occurrences..... (In pocket)	

TABLE OF AUTHORITIES CITED

CASES

	Pages
Allen v. Bryson, 25 N.W. 820 (Iowa 1885).....	27n
American Bank & Trust Co. v. Federal Reserve Bank, 256 U.S. 350, 41 S.Ct. 499 (1921).....	40n
American Service Co. v. Henderson, 120 F.2d 525 (C.C.A. 4, 1941)	69, 70
Atwater v. Wheeling & L. E. Ry. Co., 56 F.2d 720 (C.C.A. 6, 1932)	40n
Bailis v. R. F. C., 128 F.2d 857 (C.C.A. 3, 1942).....	27
Bankers Trust Company v. Florida East Coast Car Ferry Com- pany, 92 F.2d 450 (C.C.A. 5, 1937).....	12n, 45
Beckley v. Erie R. Co., 175 F.2d 64 (C.A. 6, 1949).....	71n
Bell v. Bank of California, 153 Cal. 234, 94 Pac. 889 (1908)....	82n
Black v. Richfield Oil Corp., 146 F.2d 801 (C.C.A. 9, 1944)....	71n
Blaustein v. Pan American Petroleum & Transport Co., 56 N.E.2d 705 (N.Y. 1944).....	37
Bonney v. Seely, 2 Wend. 481 (N.Y. 1829).....	30n
Boston v. District of Columbia, 19 Ct. Cl. 31 (1883).....	27n
Bray v. Cohn, 7 C.A. 124, 93 Pac. 893 (1907).....	82n
Butler v. Butler's Administrator, 8 W.Va. 674 (1873).....	30n
Byrnes v. Missouri National Bank, 7 F.2d 978 (C.C.A. 8, 1925)	73
Callaway v. Benton, 336 U.S. 132, 69 S.Ct. 435 (1949).....	41n
Case v. Los Angeles Lumber Co., 308 U.S. 106, 60 S.Ct. 1 (1939)	40n, 67
Central of Georgia Railway Co. Reorganization, 252 I.C.C. 587 (1942)	58n
Chelrob v. Barrett, 57 N.E.2d 825 (N.Y. 1944).....	38, 46
Chicago Deposit Vault Co. v. McNulta, 153 U.S. 554, 14 S.Ct. 915 (1894)	72
City Bank Co. v. Irving Trust Co., 299 U.S. 433, 57 S.Ct. 292 (1937)	70
Clark Oil Co. v. Phillips Petroleum Co., 148 F.2d 580 (C.C.A. 8, 1945).....	25
Commercial National Bank in Shreveport v. Connolly, 176 F.2d 1004 (C.A. 5, 1949).....	42, 44

	Pages
Commercial National Bank in Shreveport v. Parsons, 144 F.2d 231 (C.C.A. 5, 1944).....	43n
Commissioner v. General Gas & Electric Corp., 72 F.2d 364 (C.C.A. 2, 1934).....	62n
Commissioner v. Phipps, 336 U.S. 410, 69 S.Ct. 616 (1949)....	63
Comstock v. Group of Institutional Investors, 335 U.S. 211, 68 S.Ct. 1454 (1948).....	31, 38
Concord Coal Co. v. Ferrin, 51 Atl. 283 (N.H. 1901).....	27n
Connecticut Ry. Co. v. Palmer, 305 U.S. 493, 59 S.Ct. 316 (1939)	25
Consolidated Cut Stone Co. v. Seidenbach, 114 P.2d 480 (Okla. 1941)	28
Consolidated Rock Products Co. v. DuBois, 312 U.S. 510, 61 S.Ct. 675 (1941).....	31, 41, 66
Cooper v. Central Alloy Steel Corporation, 43 Ohio App. 455, 183 N.E. 439 (1931).....	44
Country Club District Service Co. v. Edina, 8 N.W.2d 321 (Minn. 1943)	27n
County of Los Angeles v. Cline, 185 Cal. 299, 197 Pac. 67 (1921)	66n
Crawford v. Mexican Petroleum Co. of Delaware, 130 F.2d 359 (C.C.A. 2, 1942).....	37
DeLamar Mines of Montana v. Mackay, 104 F.2d 271 (C.C.A. 9, 1939).....	38
Dobson v. Commissioner, 320 U.S. 489, 64 S.Ct. 239 (1943)...	64
Dorrance v. Phillips, 85 F.2d 660 (C.C.A. 3, 1936).....	12n
Duda v. Sterling Mfg. Co., 178 F.2d 428 (C.A. 8, 1949).....	41
Duke Power Co. v. Commissioner, 44 F.2d 543 (C.C.A. 4, 1930)	44
Duryee v. Erie R. Co., 175 F.2d 58 (C.A. 6, 1949).....	37, 71
Dusenka v. Dusenka, 21 N.W.2d 528 (Minn. 1946).....	27n
Ecker v. Western Pacific R. Corp., 318 U.S. 448, 63 S.Ct. 692 (1943)	5, 60, 69
Edwards v. Lee's Administrator, 96 S.W.2d 1028 (Ky. Ct. of App. 1936).....	46
Erickson v. Hochbrune, 91 Pac. 485 (Wash. 1907).....	27n
Erie Lighting Co. v. Commissioner, 93 F.2d 883 (C.C.A. 1, 1937)	62n

	Pages
Espach v. Nassau & Suffolk Lighting Co., 31 N.Y.S.2d 259 (1941)	38
Estate of Bell, 153 Cal. 331, 95 Pac. 372 (1908).....	82n
Everett v. Phillips, 288 N.Y. 227, 43 N.E.2d 18 (1942).....	38
Farmers' Loan & Trust Co. v. Central Railroad Co., 7 Fed. 537 (C.C., D. Ia. 1880).....	72
Foust v. Munson SS Lines, 299 U.S. 77, 57 S.Ct. 90 (1936)....	70
Gardner v. New Jersey, 329 U.S. 565, 67 S.Ct. 467 (1947)....	68
Geddes v. Anaconda Copper Mining Co., 254 U.S. 590, 41 S.Ct. 209 (1921).....	38
Goggin v. Bryan, 172 F.2d 868 (C.A. 9, 1949).....	68
Goldie v. Cox, 130 F.2d 695 (C.C.A. 8, 1942).....	41n
Greek Catholic Congregation of Borough of Olyphant v. Plummer, 32 A.2d 299 (Pa. 1943).....	28
Gregory v. Helvering, 293 U.S. 465, 55 S.Ct. 266 (1935).....	26, 64
Gross v. Cadwell, 30 Pac. 1052 (Wash. 1892).....	27n
Group of Inst. Investors v. Chicago, M. St. P. & P. R. Co., 318 U.S. 523, 63 S.Ct. 727 (1943).....	69
Guaranty Trust Co. v. York, 326 U.S. 99, 65 S.Ct. 1464 (1945)	82n
Guaranty Trust Company of New York v. Henwood, 86 F.2d 347 (C.C.A. 8, 1936).....	69
Guetzkow Bros. Co. v. Breese, 72 N.W. 45 (Wis. 1897).....	40n
Hall v. Creswell, 12 Gill & Johnson 26 (Md. 1841).....	30n
Hanna v. Bricton Mfg. Co., 62 F.2d 139 (C.C.A. 8, 1932)....	83
Hart Glass Mfg. Co. v. United States, 48 F.2d 435 (Ct. Cl. 1931)	12n
Hellier v. Baush Machine Tool Co., 21 F.2d 705 (C.C.A. 1, 1927)	37, 38
Helvering v. Morgan's, Inc., 293 U.S. 121, 55 S.Ct. 60 (1934)	44, 62n
Hippodrome Building Co. v. Irving Trust Co., 91 F.2d 753 (C.C.A. 2, 1937).....	70
Hopkins v. Detrick, 97 A.C.A. 55, 217 P.2d 78 (1950).....	44
Houck v. Hubbard Milling Co., 167 N.W. 1038 (Minn. 1918)..	28
In re Beck, 92 Fed. 889 (S.D. Iowa 1899).....	41n

	Pages
In re Central Funding Corporation, 75 F.2d 256 (C.C.A. 2, 1935)	61
In re Colorado & S. R. Co., 84 F.Supp. 134 (D.C. Colo. 1949)	71n, 75
In re Commonwealth Light & Power Co., 141 F.2d 734 (C.C.A. 7, 1944).....	31
In re Connecticut Co., 95 F.2d 311 (C.C.A. 2, 1938).....	41n
In re Ducker, 134 Fed. 43 (C.C.A. 6, 1905).....	37
In re Erie Lumber Co., 150 Fed. 817 (S.D. Ga. 1906).....	73
In re Hines, 69 F.2d 52 (C.C.A. 2, 1934).....	41n
In re Missouri Pacific Railroad Co., Docket No. 6935 (E.D. Mo. 1947).....	45
In re Peyton Realty Co., 148 F.2d 771 (C.C.A. 3, 1945).....	71n
In re Songood Realty Co., 32 F.Supp. 121 (E.D. N.Y. 1940)....	41n
In re Watts and Sachs, 190 U.S. 1, 23 S.Ct. 718 (1903).....	83
In re Western Pacific R. Co., 34 F.Supp. 493 (N.D. Cal. 1940)	5, 59, 61
In re Western Pacific R. Co., 124 F.2d 136 (C.C.A. 9, 1941)..	5
In the matter of The Western Pacific Railroad Company, Debtor, No. 12159 (C.A. 9).....	81n
Insurance Group v. D. & R. G. W. R. Co., 329 U.S. 607, 67 S.Ct. 583 (1947).....	60, 67
International Radio Telegraph Co. v. Atlantic Communication Co., 290 Fed. 698 (C.C.A. 2, 1923).....	37, 38
Isaacs v. Hobbs Tie & T. Co., 282 U.S. 734, 51 S.Ct. 270 (1931)	39, 83
J. C. F. Holding Corp. v. General Gas & Elec. Corp., 46 N.Y.S. 2d 605 (1943).....	37
Jacobson v. Mead, 12 C.A.2d 75, 55 P.2d 285 (1936).....	82n
Jordahl & Co., 35 B.T.A. 1136 (1937).....	56n
Kelley v. Caplice, 23 Kan. 337 (1880), aff'd 27 Kan. 359 (1882)	40n
Kendrick v. Forney, 22 Gratt. 748 (Va. 1872).....	30n
Koppers Co., 8 T.C. 886 (1947), 11 T.C. 894 (1948).....	45
Krier v. Krier, 28 C.2d 841, 172 P.2d 681 (1946).....	82n
Lackawanna Iron & Coal Co. v. Farmers' Loan & T. Co., 176 U.S. 298, 20 S.Ct. 363 (1900).....	78n
Lain v. Rennert, 32 N.E.2d 375 (Ill. App. 1941).....	40n

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ix

	Pages
Lazzarevich v. Lazzarevich, 88 C.A.2d 708, 200 P.2d 49 (1948)	82n
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Leiman v. Guttman, 336 U.S. 1, 69 S.Ct. 371 (1949).....	74
Manufacturers Trust Co. v. Becker, 338 U.S. 304, 70 S.Ct. 127 (1949)	35
McColgan v. Maier Brewing Co., 134 F.2d 385 (C.C.A. 9, 1943)	68, 71n, 74, 75
Meriwether v. Garrett, 102 U.S. 472 (1880).....	48, 64
Mohonk Realty Corp. v. Wise Shoe Stores, 111 F.2d 287 (C.C.A. 2, 1940).....	71n
Montezuma Canal v. Smithville Canal, 218 U.S. 371, 31 S.Ct. 67 (1910).....	82n
Moore v. Scott, 55 F.2d 863 (C.C.A. 9, 1932).....	83
Myers v. Louisiana & A. Ry. Co., 7 F.Supp. 97 (W.D. La. 1934)	36
North American Car Corp. v. Peerless W. & V. Mach. Corp., 143 F.2d 938 (C.C.A. 2, 1944).....	71n
Northern Finance Corp. v. Burns, 5 F.2d 11 (C.C.A. 8, 1925)	72
Northern Pacific Ry. v. Boyd, 228 U.S. 482, 33 S.Ct. 554 (1913)	67
Northern Pacific Railway Co. v. Slaght, 205 U.S. 122, 27 S.Ct. 442 (1907)	82n
Perkins v. Lukens Steel Co., 310 U.S. 113, 60 S.Ct. 869 (1940)	24
Peters v. Adams, 190 N.Y.S. 220 (Cty. Ct. 1920) aff'd 188 N.Y.S. 945 (App. Div. 1921).....	27n
Potter v. Carpenter, 76 N.Y. 157 (1879).....	27n
Railroad Company v. United States, 103 U.S. 703 (1881).....	66n
Rees v. Schmits, 164 Ill. App. 250 (1911).....	40n
Reinecke v. Gardner, 277 U.S. 239, 48 S.Ct. 472 (1928).....	6n, 68
Richter v. Henningsan, 110 Cal. 530, 42 Pac. 1077 (1895).....	82n
Rosaly v. Gonzales, 106 F.2d 169 (C.C.A. 1, 1939).....	37
Russo v. Hosmer, Inc., 44 N.E.2d 641 (Mass. 1942).....	29

	Pages
Securities and Exchange Commission v. Chenery Corp., 318 U.S. 80, 63 S.Ct. 454 (1943).....	35n
S. E. C. v. United States Realty Co., 310 U.S. 434, 60 S.Ct. 1044 (1940)	40
Sellers v. Bell, 94 F.2d 801 (C.C.A. 5, 1899).....	41n
Skelly v. Dockweiler, 75 F.Supp. 11 (S.D. Cal. 1947).....	38
415 South Taylor Building Corp., 2 T.C. 184 (1943).....	6n, 68
Spreckels, J. D. & A. B. Co. v. Commissioner, 41 B.T.A. 370 (1940)	25n
St. Louis-San Francisco Railway Co. Reorganization, 257 I.C.C. 399 (1944).....	58n
Stagg v. Insurance Company, 10 Wall. 589 (U.S. 1871).....	66n
Standard Steel Works v. American Pipe & Steel Corp., 111 F.2d 1000 (C.C.A. 9, 1940).....	71n
Stark v. Wickard, 321 U.S. 288, 64 S.Ct. 559 (1944).....	24
Straube v. Bowling Green Gas Co., 227 S.W.2d 666 (Mo. 1950)	28
Succession of Dinkgrave, 31 La. Ann. 703 (1879).....	30n
Taylor v. Standard Gas Co., 306 U.S. 307, 59 S.Ct. 543 (1939)	67
Texas and Pacific Railway Co. v. Bloom, 164 U.S. 636, 17 S.Ct. 216 (1897).....	75n
Texas and Pacific Railway Co. v. Johnson, 151 U.S. 81, 14 S.Ct. 250 (1894).....	75n
Tilney v. City of Chicago, 134 F.2d 682 (C.C.A. 7, 1943).....	24
Trice v. Comstock, 121 Fed. 620 (C.C.A. 8, 1903).....	31n
Trower v. City and County of San Francisco, 157 Cal. 762, 109 Pac. 617 (1910).....	82n
Truncale v. Universal Pictures Co., 76 F.Supp. 465 (S.D. N.Y. 1948)	45
Union Trust Co. v. Illinois Midland Co., 117 U.S. 434, 6 S.Ct. 809 (1886).....	73
United States v. Butler, 297 U.S. 1, 56 S.Ct. 312 (1936).....	48, 64
United States v. Butterworth-Judson Corp., 269 U.S. 504, 46 S.Ct. 179 (1926).....	61
United States v. California & Ore. Land Co., 192 U.S. 355, 24 S.Ct. 266 (1904).....	82n
United States v. Donaldson Realty Co., 106 F.2d 509 (C.C.A. 8, 1939).....	62n

	Pages
U. S. Fidelity & Guaranty Co. v. Bray, 225 U.S. 205, 32 S.Ct. 620 (1912)	39
Vanderbilt University v. Williams, 280 S.W. 689 (Tenn. 1926)	29
West Virginia Rail Co. v. Jewett Bigelow & Brooks Coal Co., 26 F.2d 503 (E.D. Ky. 1928)	12n
Western Pac. R. Co. Reorganization, 230 I.C.C. 61 (1938)	4, 5
Western Pac. R. Co. Reorganization, 233 I.C.C. 409 (1939)	5, 66, 78
Williams v. Southern Pacific R. Co., 150 Cal. 624, 89 Pac. 599 (1907)	82n
Woolford Realty Co. v. Rose, 286 U.S. 319, 52 S.Ct. 568 (1932)	44
Wright v. Sheldon, 53 Atl. 59 (R.I. 1902)	27n

STATUTES AND REGULATIONS

Bankruptcy Act:	
Chapter X	70, 74
Section 7(b)	41n
Section 77	2, 68, 74
Section 77(e)	73, 77
Section 77(f)	72, 72n
Section 77(1)	41n
Bankruptcy Rules	
General Order 44	37
California Code of Civil Procedure, Section 339(1)	82n
California Corporations Code, Section 15030	31n
Internal Revenue Code:	
Sec. 23(g)	9
Sec. 23(g)(4)	23, 30
Sec. 51(b)	64
Sec. 52	6n
Sec. 122(b)	10
Sec. 127(c)	54
Sec. 129	64
Sec. 141	62
Sec. 141(d)	50
Public Utility Holding Company Act of 1935	50, 51

	Pages
Revenue Act of 1918, Sec. 240(b).....	62n
Revenue Act of 1921, Sec. 240(b).....	56n
Revenue Act of 1924.....	56n, 62n
Revenue Act of 1926.....	56n
Revenue Act of 1928.....	62n
Securities and Exchange Commission Regulations, Rules and Releases :	
Regulation S-X, Rule 3.14.....	78n
Rule U-45(b) (6).....	53, 55
Release No. 53, Accounting Series "In the Matter of 'Charges in Lieu of Taxes' ", November 16, 1945, 3 C.C.H. Fed. Sec. Law Serv. 2d ed., Par. 72,071.....	52, App. 7
Release No. 4444, July 28, 1943, "In the Matter of Consoli- dated Electric Gas Company, The Islands Gas & Electric Company"	54
Release No. 4806, January 3, 1944, "In the Matter of Con- solidated Electric & Gas Company".....	55
Release No. 5535, January 3, 1945, "In the Matter of Cities Service Company"	54
Treasury Regulations, Rulings and Decisions :	
I.T. 3252 [1939-I Cum. Bull. 182].....	39n
I.T. 3637 [1944 Cum. Bull. 258].....	56n, App. 17
I.T. 3692 [1944 Cum. Bull. 261].....	56n, App. 21
Reg. 75, Art. 15(a) (1928).....	56n
Reg. 78, Art. 15(a) (1932).....	56n
Reg. 89, Art. 15(a) (1934).....	56n
Reg. 97, Art. 15(a) (1936).....	56n
Reg. 102, Art. 15(a) (1938).....	56n
Reg. 104.....	56n
Reg. 104, Sec. 23.15(a) (1942).....	56n
Reg. 104, Sec. 23.15(b).....	6n
Reg. 104, Sec. 23.16.....	12n, 34
Reg. 104, Sec. 23.34(c).....	56n
Reg. 110.....	56n
Reg. 111, Sec. 29.23(e)-4 (I.R.C.).....	39n
T.D. 5086, Amendments to Regulations 103 [1941-2 Cum. Bull. 46-7].....	56n, App. 23
Uniform Partnership Act, 7 U.L.A. Sec. 30.....	31n

	Pages
TEXTS, TREATISES & OTHER MATERIAL	
Accountant's Weekly Report, Vol. 6, No. 1 (Sept. 29, 1947).....	78n
Barnes, The Economics of Public Utilities Regulation (1947) p. 73.....	61n
Bonbright and Means, The Holding Company (1932) p. 147....	61n
6 California Jurisprudence, p. 492.....	82n
Collier on Bankruptcy (14th ed.) Par. 62.30 p. 1573.....	41n
Collier on Bankruptcy (14th ed.) Sec. 77.02, pp. 468, 469....	69
Collier on Bankruptcy (14th ed.) Sec. 11.18, pp. 3922-24.....	70
Congressional Reports and Hearings:	
Hearings before the House Committee on Interstate and Foreign Commerce, 74th Cong., 1st Sess., on H.R. 5423, pp. 153, 849, 992, 1061, 1522.....	51n
Hearings before the Senate Committee on Interstate Com- merce, 74th Cong., 1st Sess., on S. 1725, pp. 83, 122, 255, 557	51n
Hearings before the Senate Finance Committee on the Reve- nue Act of 1928.....	App. 23
Hearings before the Senate Finance Committee on the Reve- nue Act of 1932, p. 24.....	49n
Hearings before the House Ways and Means Committee on the Revenue Revision of 1934, pp. 86, 99.....	49n, App. 23
Hearings before the Senate Finance Committee on the Reve- nue Act of 1934.....	App. 24
Hearings before the Senate Finance Committee on the Reve- nue Act of 1940.....	App. 24
Hearings before the House Ways and Means Committee on Revenue Revision of 1942.....	App. 24
Joint Hearings of the House Ways and Means Committee and the Senate Finance Committee on Excess Profits Taxa- tion, 1940	App. 24
House Ways and Means Committee Reports on the Revenue Bills of 1921, 1928, 1934.....	App. 23
Memorandum of the Senate Finance Committee on the 1918 Revenue Act	49n, App. 23
Preliminary Report of Sub-Committee of House Committee on Ways and Means on Prevention of Tax Avoidance, 1933	App. 23

	Pages
Report of Joint Committee on Internal Revenue Taxation on the Revenue Act of 1926, p. 63.....	49n, App. 23
Report of Senate Finance Committee on the Revenue Act of 1928, Sen. Rep. No. 960, 70th Cong., 1st Sess., pp. 1, 13, 29	49n
Report of Senate Finance Committee on the Revenue Act of 1932, Sen. Rep. No. 665, 72d Cong., 1st Sess.....	49n
Report of House Ways and Means Committee on the Revenue Act of 1934, H. Rep. 704, 73d Cong., 2d Sess., p. 16..	49n
Senate Finance Committee Reports on the Revenue Bills of 1918, 1921, 1928, 1932, 1934.....	App. 23
2 Dewing, The Financial Policy of Corporations (4th ed. 1941) pp. 1042, 1051.....	61n
16 Fletcher, Corporations (Perm. Ed.) Sec. 8174.....	32n
5 Mertens, Law of Federal Income Taxation (1942) pp. 256-57	39n
8 Mertens, Law of Federal Income Taxation (1942) Sec. 46.13, p. 426.....	62n
Moody's Industrial Manual 1941, p. 2598.....	45
National Association of Railroad and Utilities Commissioners Material:	
Excerpts from 1943 Report of Committee on Accounts and Statistics	App. 14
Excerpts from 1945 Report of Committee on Accounts and Statistics	App. 15
Restatement of Restitution:	
Sec. 1, p. 13.....	27
Sec. 1, pp. 356, 618.....	29
Sec. 1, p. 596.....	29
3 Scott on Trusts (1939) Sec. 344.....	31n
Summary Report of the F. T. C. to the Senate pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., Part 72-A Sen. Doc. No. 92, 70th Cong., 1st Sess., p. 478.....	50n, 57
pp. 69-70	App. 5
p. 311.....	61n
pp. 477-479	App. 2

	Pages
Treasury Department Release, "Consolidated Returns and Inter- corporate Dividends," June 9, 1948.....	63
Treasury Press Release No. 44-54, December 31, 1944, p. 16....	52n
Treasury Press Release No. V-229, February 25, 1946, pp. 6, 10	52n
Treasury Report, Statistics of Income for 1944, Part 2, Pre- liminary, pp. 10-11.....	52n
Treasury Report, Statistics of Income for 1941, Part 2, p. 293..	52n

No. 12,506

IN THE

United States Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION
and ALEXIS I. DUP. BAYARD, Receiver,
Plaintiffs and Appellants,

and

MEREDITH H. METZGER, HENRY OFFERMAN and
J. S. FARLEE & CO., INC., a corporation,
Interveners and Appellants,

vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Defendants and Appellees.

Brief for Appellees

STATEMENT OF THE CASE

These are appeals from a judgment which denied all relief to appellants. Appellant, The Western Pacific Railroad Corporation, a holding corporation which formerly owned all of the capital stock of the pre-reorganization The Western Pacific Railroad Company, brought suit against the reorganized The Western Pacific Railroad Company for \$17,201,739.00 on account of "tax savings" of court trustees who operated the railroad properties during the reorganization period. These "tax savings" were realized by the reorganization trustees primarily by reason of the entry

of the holding corporation's losses as deductions from income in consolidated tax returns. The contention is that the holding corporation, as parent of the group and as the "loss" member, is entitled to collect from the other group members the amounts thus "saved" by them in taxes. The claim is directed to the income of the reorganization trustees and the holding corporation seeks to assert that claim against the reorganized railroad company. The court below held that appellants have no cause of action and that approval of the claim would be in derogation of the reorganization plan and the purpose of Section 77 of the Bankruptcy Act.

The Facts.

1. THE PARTIES AND THEIR HISTORY.

Appellants are The Western Pacific Railroad Corporation, a Delaware holding corporation (Ex. P. 16), three of its preferred stockholders who have intervened to assert the Corporation's claims (R. 1650-52) and the receiver of the Corporation, which now has no assets and does no business. Appellees are The Western Pacific Railroad Company, a reorganized California railroad corporation, and its subsidiaries and a former affiliate. Appellants confuse three distinct entities by referring to all of them as "the company" or "defendant." These entities are

The pre-reorganization The Western Pacific Railroad Company, the stock of which was wholly owned by the Corporation;

The reorganization trustees, Messrs. Schumacher and Ehrman, who had title to and possession of the railroad properties from November, 1935, until December, 1944; and

The reorganized The Western Pacific Railroad Company in which the Corporation has no interest whatever.

It is against the latter, the reorganized company, that appellants seek judgment.

The Western Pacific Railroad Company was reorganized for the first time in 1916. The Corporation, a holding company, then acquired all the stock of the operating company (R. 493) and took charge of its affairs. In 1926 Thomas M. Schumacher became president of the Corporation and chief executive of the operating company (Ex. P. 34 B, R. 531, Ex. P. 21, R. 1719, Ex. P. 25, R. 1724); Michael J. Curry then became a vice president of the Corporation and a vice president of the operating company (Ex. P. 21, R. 1719, Ex. P. 25, R. 1724, R. 640); and in 1934 Pierce & Greer, counsel for the Corporation in this case, became, on Mr. Schumacher's recommendation (R. 793), general counsel for the Corporation and counsel for the operating company (R. 793, 1031). The Corporation's New York office was the head office of the group (R. 737) where policy was established and all significant decisions made (R. 740-42). The New York office was also made the fiscal office of the operating company (R. 740) and the office expense was divided between the Corporation and the company (R. 643-44). The Corporation in conventional fashion and for its own purposes created and maintained over the years the duality on which it now lays emphasis.

In 1925 Arthur Curtiss James acquired directly or through his companies approximately 61 per cent of the common and 8.8 per cent of the preferred stock of the Corporation (R. 501). From then and until February 1942 the James interests were represented on the Board of Directors of the Corporation (R. 1480, Ex. P. 22, R. 1720). Since that date no one of the Corporation's directors has been identified with any particular interest. During the years important here the Corporation's directors were Thomas M. Schumacher, a seasoned railroad executive (R. 993, 1231), past president of the Corporation and for many years chief executive of the Western Pacific system (R. 1719, 1724); M. J. Curry, for many years Mr. Schumacher's principal assistant (R. 736, 135) described by the trial court as "a perfectly competent man,

intelligent, and probably a pretty good railroad man" (R. 785); A. Perry Osborn, an experienced New York lawyer who is of counsel for appellants in this action and who came to the Board at the suggestion of the Chase National Bank (R. 990); Willis D. Wood, a broker (R. 1121), past governor of the New York Stock Exchange (R. 1122) and director of many well-known companies (R. 1122-23); and H. Brua Campbell, a member of the firm of Pierce & Greer. The other four directors were office employees of the New York office appointed to fill vacancies occurring during the reorganization years (R. 1138-39). The officers of the Corporation were M. J. Curry and two office employees, Mary C. Valouch and J. F. Wienken (Ex. P. 21, R. 1719).¹

2. THE REORGANIZATION.²

Between 1916 and 1935 the Corporation caused its subsidiary, the operating company, to sell securities in large amounts to the public. The Corporation was unsuccessful in its management of the company and by 1935 the company was unable to pay interest on its outstanding indebtedness of approximately \$70,000,000 (230 I.C.C. 64). The Corporation directed it to file a petition for reorganization.

The railroad properties were transferred by the bankruptcy court to its reorganization trustees, Thomas M. Schumacher, president of the Corporation, who became a trustee upon its recommendation (R. 1627), and Sidney M. Ehrman, a San Francisco lawyer (R. 1223-24). Charles Elsey, president of the debtor and later to become president of the reorganized company, was managing agent for the trustees (R. 1224, 1251).

¹For a tabulation of the officers and directors of the Corporation and their terms of service see Appendix A, p. 1.

²For the convenience of the Court a "Chronology of Reorganization Proceedings" and, in parallel therewith, a "Chronology of Tax Returns and Related Occurrences," have been prepared and have been placed in a pocket on the inside of the back cover to this brief. These chronologies will aid the Court in reviewing the sequence and relation of events.

The plan of reorganization formulated by the Interstate Commerce Commission (230 I.C.C. 61, 233 I.C.C. 409) limited the first mortgage bonds of the reorganized company to \$10,000,000 to be exchanged for trustee's certificates (Par. O, 233 I.C.C. 451); it required the old first mortgage bondholders to exchange their securities for income bonds, preferred and common stock; and it declared that the stock interest in and unsecured claims against the old company were totally valueless (Par. P(5), 233 I.C.C. 452). Junior secured interests were not paid in full by at least \$3,495,900, plus interest (Ex. D. 33, R. 2021). The Commission plan was approved by the Supreme Court (*Ecker v. Western Pacific R. Corp.*, 318 U.S. 448, 63 S.Ct. 692 (1943)) after review by this Court (*In re Western Pacific R. Co.*, 124 F.2d 136 (C.C.A. 9, 1941)) and the court below (*In re Western Pacific R. Co.*, 34 F. Supp. 493 (N.D. Cal. 1940)). In October 1943, after submission to and approval by the participating creditors, the plan was confirmed by the District Court (Ex. P. 10, R. 1674). A reorganization committee consisting of Frederick H. Ecker, representing institutional bondholders, Frank C. Wright, representing the Reconstruction Finance Corporation, and Robert E. Coulson, representing Railroad Credit Corporation and the A. C. James Company, was appointed (Ex. P. 10, R. 1674); the securities of the old company were surrendered with the approval of the reorganization court (Ex. P. 13, R. 1706) to the reorganization committee (Ex. P. 11, R. 1679) and later cancelled; new securities were issued; and on December 31, 1944, the railroad properties were turned over to the reorganized company, the appellee here (Ex. P. 14, R. 1711, R. 36-108). With the approval of the reorganization court (Ex. P. 13, R. 1706) and under authority of the reorganization plan (Par. R, 233 I.C.C. 453), the corporate charter of the old company was retained for the reorganized concern (Ex. P. 13, R. 1706). The reorganization proceeding was closed by a final order dated March 28, 1946 (Ex. D. 32, R. 2013).

The Corporation intervened in the reorganization on December 11, 1939 (Ex. D. 29, R. 1994) and thereafter remained a party to the proceeding, represented by Judge Marcus C. Sloss of San Francisco (R. 1600-03).

This litigation is a dispute about taxes³ and "tax savings" for the years 1942, 1943 and the first four months of 1944, a period during which the railroad properties were owned, controlled and operated by the trustees of the bankruptcy court. It is a dispute about "tax savings" of those trustees.

The Corporation depended for its income on interest and dividends from securities of The Western Pacific Railroad Company and the Denver & Rio Grande Western Railroad Company (R. 748). With both the Western Pacific and Denver & Rio Grande properties in reorganization, the Corporation had no substantial income (R. 575) and its financial situation grew critical. For a time it succeeded in borrowing from its secured creditors to pay its office expenses (R. 771-72, 789, Ex. D. 4 C id., R. 1859). When these advances stopped, the Corporation renewed its earlier suggestion (Ex. D. 3, R. 1839, 1845, 1852-53) that the reorganization trustees assume a larger share of the New York office expense. The trustees, after consultation with the reorganization court (R. 1230-31) and to the knowledge of the Corporation's directors (R. 1002-3), agreed to assume and did assume all expense of the joint New York office (Ex. P. 30, R. 1738). The arrangement had no relation to income tax problems of the trustees (R. 1245, 1257). As an economy measure, Mr. Schumacher in 1942 resigned as president of the Corporation (R. 743) and Mr. Curry was elected by the Board as his successor (R. 644, 1016).

³On income earned by the railroad properties during the reorganization the trustees were the taxpayers. I.R.C. Sec. 52; *Reinecke v. Gardner*, 277 U.S. 239, 241, 48 S.Ct. 472, 473 (1928); 415 *South Taylor Building Corp.*, 2 T.C. 184, 192 (1943). The trustees were entitled to join in the consolidated returns. I.R.C. Section 52, Treas. Regs. 104, Sec. 23.15(b).

3. TAXES PRIOR TO 1942.

In each year beginning with 1918 the Corporation prepared, signed and filed in New York consolidated tax returns for itself and all group members (R. 1258-59, 843-44, Ex. D. 40). Beginning in 1927 Mr. Curry, first as treasurer (R. 846) and after February 1, 1942, as president of the Corporation (Ex. P. 21, R. 1719) supervised preparation of the returns (R. 844-45) and signed and filed them (R. 846, 831, 664, 666). In each year the tax owing under those returns was allocated among the group members according to the formula universally accepted, that is: the consolidated return tax was distributed pro rata to those members of the group who had taxable incomes without allocating any tax to a "loss company" or paying that company for the tax "saved" by the use of the loss in the returns (R. 1262, Ex. D. 40). This approved practice was followed during the years here in question (Ex. D. 40).

4. TAXES FOR 1942.

During that part of the reorganization period prior to 1941, income was low and losses were large. No tax was reported owing in the consolidated returns and none was paid.⁴ In 1942 it became apparent that the reorganization trustees, with substantial war income, might become liable for a large tax payment. Mr. Curry, who knew of the large earnings of the trustees and that the Corporation with no earnings would pay no tax (R. 836), supervised preparation of tentative consolidated returns for 1942, and signed and filed them on March 15, 1943 (R. 831) and arranged for an extension of time until May 15, 1943,

⁴In each of the years 1935 to 1941, inclusive, taxes were "saved" for one or more group members through the use of group losses in consolidated returns. No "tax savings" payments were made or demanded. See Ex. D. 40. (In this brief, exhibit references unaccompanied by record citations refer to exhibits which with leave of Court have not been printed.)

to file the final returns (R. 1881-82). Shortly thereafter F. C. Nicodemus, Jr., counsel for the Corporation, who had discussed the 1942 returns with Mr. Curry (R. 697-698), noting "the very critical question" as to whether the final returns should be consolidated or separate returns (Ex. P. 39-B, R. 544), suggested to Mr. Schumacher that the trustees obtain expert tax advice from the New York law firm of Whitman, Ransom, Coulson & Goetz (Ex. P. 39-B, R. 544, 1079). James K. Polk, a member of that firm, had worked with consolidated returns for many years both in and out of the Bureau of Internal Revenue (R. 1396-98). Mr. Schumacher consulted with Mr. Ehrman and they decided to employ the Whitman firm (Ex. P. 39-E, R. 1746, 1233).

Mr. Polk reviewed the tax history of the group (R. 1400), arranged for an independent tax accountant to assist the New York office employees in the preparation of the returns (R. 1402), considered various alternatives (R. 1404, 1444-45) and recommended that final consolidated returns be filed for 1942. The final returns, prepared in the New York office (R. 830), were signed and filed by Mr. Curry, president of the Corporation, on May 15, 1943 (R. 831, 837). They reported a consolidated tax of \$4,201,821.54 (Ex. P. 3 A/B). With insignificant exceptions this tax resulted from the earnings of the reorganization trustees (Ex. D. 40) and the trustees provided from the bankruptcy estate the funds from which the tax was paid (R. 824, 826, 1306-07), allocating to the subsidiaries of the operating company in accordance with the traditional formula the small amounts of tax owing from them (Ex. D. 40).

5. TAXES FOR 1943.

Shortly after the 1942 returns were filed Mr. Polk reviewed the tax situation with Mr. Curry and Mr. Nicodemus, pointing out the advantages of consolidated returns (R. 839, 1079-1080),

and prepared a detailed written report dated May 20, 1943, which was addressed to Mr. Curry (Ex. P. 50, R. 1757) and circulated to Mr. Schumacher (R. 862) and Mr. Nicodemus (Ex. D. 9, R. 1884), who reviewed it together (R. 864). A copy of the report was provided to Mr. Elsey (R. 1266). The report reviewed the tax advantages of consolidated returns and suggested the possibility that under the recently enacted amendment to Section 23(g) of the Internal Revenue Code the loss of the Corporation, upon a determination that its stock in the old company was worthless, might constitute under consolidated returns an offset to income of other group members (Ex. P. 50, R. 1757).

During the fall of 1943 the courts finally determined that the Corporation's interest in the old company was worthless. The loss of the Corporation, calculated for tax purposes at \$73,478,-023.04, greatly exceeded group income for 1943 (Exs. P. 4A, 4B, Ex. D. 40). As an economic matter the Corporation's loss had accrued over the years as the financial condition of the old company became increasingly acute; as a tax matter it was realized, according to Mr. Polk's opinion, when the order confirming the plan of reorganization became final in November 1943 (Ex. P. 54, R. 606, 1409-10). It was therefore a 1943 loss.

Consolidated returns reporting the loss of the Corporation as an offset to group income were prepared in the joint New York office (R. 1414), signed by Mr. Curry (R. 664), and filed by him on July 15, 1944 (Exs. P. 4A, 4B). Mr. Curry had been consulted from time to time in connection with the preparation of the returns (R. 1415) and he knew that they reported the Corporation's loss as a deduction (R. 682, 702-4). The returns reported no tax owing (Exs. P. 4A, 4B). Some months earlier the reorganization trustees, recognizing the uncertainties in the 1943 tax situation, had asked the reorganization court for leave to establish a reserve for taxes (Ex. P. 58, R. 1772). A hearing was held (R. 1270-74); the tax situation was reviewed (Ex. D.

34, R. 2023, 1270-74); and an order entered approving a reserve for tax purposes of \$7,100,000 (Ex. D. 12, R. 1895). Judge Sloss and Mr. Nicodemus, attorneys for the Corporation, received notice of the hearing and the action taken (R. 1991, 1217). Mr. Curry understood that Mr. Nicodemus knew that consolidated returns would be filed for 1943 (R. 889). Mr. Nicodemus received a copy of Mr. Polk's written report of May 20, 1943 (R. 1884), a copy of the annual report of the trustees for 1943 which discussed taxes (R. 1086) and of the December, 1943, form 174A statement reporting the reversal of tax accruals (R. 1083-4).

6. TAXES FOR 1944 AND THE 1942 REFUND CLAIM.

Under the carryback provisions of the Internal Revenue Code (I.R.C. Sec. 122(b)) the group was entitled to carry back the 1943 loss and claim a refund of the tax paid for 1942. A refund claim, prepared by Mr. Polk as a routine matter (R. 1450), was signed by Mr. Curry (R. 667) and filed in due course on March 9, 1945 (Ex. P. 6, R. 1654).

The Internal Revenue Code also provided (I.R.C. Sec. 122(b)) that the 1943 loss could be carried forward to apply to 1944 income. The 1944 returns, reporting no tax owing (Exs. P. 5A, 5B), were signed and filed by Mr. Curry (R. 666) on July 15, 1945 (Exs. P. 5A, 5B). In the meantime and on April 30, 1945, the New York office had been closed (R. 650 A, 891) and Mr. Curry, after some preliminary conversation on his behalf by Mr. Nicodemus and Mr. Osborn with Mr. Coulson (R. 1017, 1110), had taken up quarters in the suite of Whitman, Ransom, Coulson & Goetz under a retainer arrangement whereby his services were to be available in connection with tax matters (Ex. P. 33, R. 529). The Corporation directors were familiar with this arrangement (R. 899, 901-03, 1017) and Mr. Curry testified that during the period he had his office in the Whitman suite no attempt was

made to influence his activities as Corporation president and that he was entirely free to take any action he thought advisable with respect to the Corporation's affairs (R. 904).

The returns for 1944 related only to the first four months of the year. On May 1, 1944, with the approval of the reorganization court (Ex. D. 23, R. 1930) and the stockholders of the Corporation (Exs. D. 1, D. 2, R. 1830-31), the stock of the old company held by the Corporation was surrendered to the reorganization committee (R. 493) and later cancelled, thus terminating the group affiliation and the possibility of consolidated returns.

7. THE SETTLEMENT WITH UNITED STATES.

Mr. Polk, holding powers of attorney from all group members (Ex. P. 65, R. 1784, R. 1441), represented the group in connection with the audit of the returns. He wrote a letter (Ex. P. 64, R. 1779) to and held conferences with Bureau of Internal Revenue representatives in New York and Washington (R. 1418-20, 423-31) which culminated in a proposal that the United States accept the returns for 1942, 1943 and the first four months of 1944 as filed and deny the refund claim designed to recover the \$4,201,821.54 paid as 1942 tax (Ex. In. 14, R. 2142). This meant that the tax liability for the entire period of two years and four months would be discharged by the payment of \$4,201,821.54. The Bureau eventually accepted this proposal (Ex. P. 7, R. 1664-65).

Mr. Polk, with the approval of the reorganized company (Ex. P. 72, R. 1801), which was responsible for the taxes of the trustees (Ex. P. 15, R. 1711), submitted his settlement proposal to the Bureau on February 11, 1947 (Ex. In. 14, R. 2142). On April 2, 1947, he advised the Corporation in detail (Ex. P. 68, R. 1788). The directors of the Corporation, following agreement upon a stipulation in this proceeding, concluded by formal action to approve the settlement (R. 1103, R. 1644-45) which on August

13, 1947 was also accepted by the Bureau (Ex. P. 7, R. 1664). The stipulation (Ex. P. 7, R. 1658) recognizes that although the settlement was effected in form by a total rejection of the refund claim, the \$4,201,821.54 payment for 1942 was intended to be a settlement payment not for 1942 alone but for the entire period of two years and four months.⁵

From first to last these tax transactions were handled in the ordinary course of business. The returns related to a period during which affiliation continued—indeed they were possible only because affiliation continued—and they were prepared, signed and filed and the allocation of intra-group liabilities was made in strict accordance with twenty years of prior practice. Appellants have in fact no complaint about the tax returns. They agree that the returns were properly prepared, properly signed and properly filed (In. Br. 62-63, Pl. Br. 78-79). They also agree that Mr. Polk, whose purpose, like that of other tax counsel, was to obtain a favorable tax result for the group, discharged that duty in a completely satisfactory fashion. (R. 1007, 1103)

8. THIS LITIGATION AND THE OPINION BELOW.

In June, 1946, the interveners, claiming to own 6.7% of the preferred stock of the Corporation,⁶ began a stockholders' suit

⁵Any refund which the United States might have made pursuant to the refund claim would have belonged to the reorganization trustees who paid the tax. In receiving the refund the Corporation would be acting as the agent for the actual taxpayer, Treas. Reg. 104, Sec. 23.16, and compelled to surrender the proceeds. *Bankers Trust Company v. Florida East Coast Car Ferry Company*, 92 F.2d 450, 452 (C.C.A. 5, 1937). Cf. *Hart Glass Mfg. Co. v. United States*, 48 F.2d 435 (Ct. Cl. 1931) cert. den. 286 U.S. 556; *Dorrance v. Phillips*, 85 F.2d 660, 662 (C.C.A. 3, 1936); *West Virginia Rail Co. v. Jewett Bigelow & Brooks Coal Co.*, 26 F.2d 503, 504 (E.D. Ky. 1928).

⁶Appellees offered to prove that the interveners bought their \$100 par value preferred stock in the Corporation in 1942 and thereafter at a total cost of \$37,007.39 or an average of \$1.00 per share (Exs. D 18 id., 19 id., 59 id., R. 1905-07, 2102). The evidence was excluded as irrelevant (R. 1175, 1643).

in New York charging mismanagement of the Corporation by its officers and directors in many particulars, including failure to assert a "tax saving" claim. Thereafter and on October 10, 1946, the Corporation filed this action (R. 5).

The District Court concluded that there was no equity in appellants' claim and ordered judgment for appellees. The court, believing that there had been an erroneous and unjust "escape" from taxes which should have been paid to the United States, but "compelled to rest decision upon the fundamental issue of the justice and equity of plaintiff's right, if any, to be paid for that which was escaped" (R. 272), concluded that the injustice could not be cured by "distributing the gain thus made to others" (R. 271) and held that appellants had no claim.

The District Court recognized the true nature of appellants' claim:

"A 'saving' in taxes is a negative concept. It is a benefit to one obligated to pay money, resulting from not having to pay. No benefit could inure from participating in non-payment of an obligation, unless there rested upon the participant an obligation to pay. Absent such obligation, any sharing of that which is not paid out, would be gratuitous." (R. 272-73)

* * * * *

"What plaintiff really seeks is not all or a share of the so-called tax saving. Rather it is a circuitous way of obtaining something in the nature of equity or value for its ownership, rejected in the reorganization plan. Or put differently, it is an effort to share in the earnings of the debtor during the reorganization period." (R. 272)

The court concluded that any such distribution of earnings would be contrary to the reorganization plan:

"In effect therefore, recognition of plaintiff's claim would be recognition of a right in plaintiff to share in debtor's earnings. As already stated, a demand substantially seeking

this end was heretofore asserted by way of opposition to the plan and rejected. *Ecker v. Western Pac. Co.*, 318 U.S. 448." (R. 273)

And contrary to the philosophy and purpose of the reorganization proceeding itself:

"Not only that, but the philosophy underlying Section 77 of the Bankruptcy Act stands as a barrier against the equitable validity of plaintiff's claim in this cause."

* * * * *

"When it was finally determined, after running the full gamut of court and administrative procedure, in the reorganization of the Western Pacific Railroad Company, that the plaintiff's interest was worthless, nothing short of some extraordinary cause justifying reopening the reorganization proceeding could effect a change. To make any award in this cause, under the assumed authority of equity principles, would be in effect to modify the administrative and judicial judgments in the reorganization proceeding. Such a procedure would be an indirect nullification of the purpose of the reorganization statute, in the guise of an afterthought allegedly of equitable persuasion." (R. 273-74)

The District Court therefore held

- (a) that there is no justice or equity in appellants' claim;
- (b) that to recognize the claim would be to accord appellants a share in the earnings of the reorganization trustees during the reorganization period;
- (c) that to recognize the claim would mean that the Corporation would receive value for its stock ownership, although that stock has been held to be without value;
- (d) that the Bankruptcy Act is a barrier against the assertion of appellants' claim against the reorganized The Western Pacific Railroad Company.

The District Court did not reach and had no occasion to consider the affirmative defenses of laches, statute of limitations and estoppel urged by appellees. Nor did the Court have occasion to give attention to the settled business practice, the past practice of the Western Pacific group, or the precedents relating to the distribution of intra-group liabilities in connection with consolidated returns.

9. THE "FACT" STATEMENTS BY APPELLANTS.

By seizing upon accidents of phrasing, by partial quotations, by distorting a few details and ignoring the substance of what was done,⁷ appellants seek to lead this Court to believe that the con-

⁷The briefs of appellants, particularly that of the interveners, are replete with erroneous and misleading statements. We shall exemplify briefly.

(a) It is said that "defendant was quite reluctant to disclose its use of plaintiffs' tax credit * * * , it simultaneously decided to create a tax reserve; but this reserve was to be hidden under the unrevealing designation 'Reserve for Road Improvements' " (In. Br. 33). The fact is that the use of the stock loss in the 1943 consolidated returns was plainly disclosed in the returns, prepared in the Corporation's office (R. 845-46, 1414), signed and filed by the Corporation's president (R. 664). It was fully presented in a formal hearing in the reorganization proceeding (R. 270-74) and reported in the annual reports published by the trustees (Exs. P. 20 B, 20 C, R. 511-14). As the trial court said, "It was all done right out in the open" (R. 970). The reserve to which appellants refer was established by court order (Ex. D. 12, R. 1895) and entitled "Reserve Fund for Contingent Tax Liabilities" (Ex. D. 12, R. 1895). Appellants, for their description of the reserve, rely upon a mere draft which was never used, which they have misquoted and which was to be entitled "Reserve Fund for Contingent Tax Liability and for Post-War Modernization and Improvement" (Ex. In. 19, id., R. 2155-56).

(b) Appellants say that "Plaintiff's financial collapse * * * was the signal for its officers, directors and lawyers to desert the sinking ship and to climb on that of defendant" (In. Br. 11). The fact is that the officers, directors and lawyers of the Corporation all testified that they performed their duties to the best of their ability, for the best interest of the Corporation and were not dominated or controlled in their actions by anyone (R. 743-44, 1011-16, 1046, 1126, 1136, 1143). There is no contradictory testimony.

(c) Appellants characterize Mr. Curry, the Corporation's president, as a "chief clerk" or "office manager" (In. Br. 12). The trial court, who heard him testify, characterizes Mr. Curry as "a perfectly competent man, intelligent, and probably a pretty good railroad man" (R. 785).

(d) Appellants say "without so much as asking plaintiff, defendant

duct of the persons handling the tax transactions was unfair and biased if not worse. These same arguments, based upon these same scraps of material, were pressed below with even greater

made the decision that plaintiff was to file consolidated returns and make its tax credit available to defendant" (In. Br. 18-19). The fact is that the Corporation's president himself signed and filed the returns (R. 663, 664, 666, 831, 837), that consolidated returns were obviously advantageous and that if they had not been filed appellants would have no claim.

(e) Appellants say that Mr. Polk's letter of May 20, 1943 was "addressed to defendant" (In. Br. 19). It was in fact addressed to Mr. Curry (Ex. P. 50, R. 1757), who was at that time an officer of both the Corporation and the pre-reorganization The Western Pacific Railroad Company. Mr. Curry has at no time been an officer of *defendant*, viz., the reorganized The Western Pacific Railroad Company.

(f) Appellants say that the consolidated returns for 1943 "were prepared by Valouch (then a full time employee of defendant, but neither an officer or director of plaintiff), under the supervision of Polk" (In. Br. 20). The fact is that the returns were prepared by Miss Valouch and Mr. Reilly, an independent tax accountant, under the supervision of Mr. Curry (R. 829-30, 701-02, 845-46, 1259, 1414). Mr. Polk had no part in the preparation of the returns but acted as tax counsel, that is, by giving advice (R. 1403-04, 1414-15, 1417).

(g) Appellants say of Mr. Curry after he took up his office in the suite of Whitman, Ransom, Coulson & Goetz, "he, as plaintiff's president, was to perform such services as defendant would require to achieve and safeguard the tax savings for itself" (In. Br. 21). The fact is that the retainer for Mr. Curry was arranged after Mr. Schumacher and Mr. Osborn had suggested that something be done for him because of the inadequacy of his pension (R. 1017, 1495), that he was retained in connection with tax affairs because of his familiarity with the tax matters of the group and possibly to act as a witness in pending tax matters (R. 1496-97), that Curry informed the Corporation's directors of the retainer (R. 1016-17, 899-904) none of whom disapproved (R. 903, 1017) and that he was at all times entirely free to carry out his activities as president of the Corporation with no interference whatever (R. 904).

(h) Intervener appellants say that on August 13, 1947, the tax settlement with the United States "became an accomplished fact, without ever having received advance approval by plaintiff" (In. Br. 25). The fact is that prior to the receipt of information of the Government's action the directors of the Corporation had considered the matter at length and decided against withdrawal of the offer of settlement (R. 1644-5).

(i) Appellants say that not until shortly before this action was filed did either Mr. Osborn or Mr. Wood know "that the plaintiff's stock loss was being used in tax returns or that thereby defendant was saving taxes; neither knew or was advised of the legal or economic consequences of the filing of the returns involved in this case" (Corp. Br. 12). The fact is that Mr.

vigor. They failed to make any impression on the trial court. That court had before it as witnesses, on the call of appellees, the persons whom appellants by innuendo charge with conniving or incompetence: Curry (R. 636-910), Nicodemus (R. 1029-1121), Osborn (R. 988-1029), Polk (R. 1396-1477), Coulson (R. 1478-1501), Ehrman (R. 1222-49), and Elsey (R. 1249-1361). The depositions of Sheehan (R. 1138-43), Wood (R. 1121-34), Hatton (R. 1134-38), and Sloss (R. 1599-1614) were read in whole or in part. With the witnesses and the written record before him, the District Judge concluded that there was no reason to believe that the tax transactions were handled other than in an open, competent, candid and unbiased fashion and cut short the exposition of the details (R. 970, 977, 986) and intervenor's argument concerning them. The court said:

"The Court: Well, I can follow all that argument or I could if there were some concealment involved. But when everybody was, as they were in this case, acting completely in the open in the matter, nobody was concealing anything from anyone else, the element of fraud or deception, of the kind that you refer to, is absent.

* * * * * *

"Everybody knew that consolidated returns were being filed. Everybody knew who the directors were. Everyone knew that these attorneys were being employed to file this consolidated return. It was all done right out in the open." (R. 970)

Osborn knew that consolidated returns were being filed (R. 1019) and that they conferred substantial benefits on the trustees (R. 1020-22). Mr. Wood had no doubt that consolidated returns would be filed (R. 1132-3).

(j) Appellants say that by reason of the stockholders' suit filed in June 1946 "plaintiff's board of directors first learned of the use of plaintiff's stock loss in consolidated returns to the advantage of the defendant Operating Company" (Corp. Br. 24). The fact is that Mr. Curry knew of the use of the Corporation's loss as a deduction at the time the 1943 returns were filed (R. 682, 702-4), that Mr. Schumacher was familiar with the tax transactions throughout (R. 876-77), that Mr. Osborn knew that consolidated returns conferring a benefit on the trustees were being filed (R. 1019-22), and that Mr. Wood had no doubt that consolidated returns could be filed (R. 1132-33).

SUMMARY OF THE ARGUMENT

Appellants claim for the Corporation, as former owner of the stock of the pre-reorganization The Western Pacific Railroad Company, the benefit of the "tax saving" realized by the reorganization trustees through the entry of the Corporation's loss as a deduction from income in the consolidated returns. That claim fails: first, because it is without merit; second, because it is presented against a party not liable, viz., the reorganized The Western Pacific Railroad Company; and, third, because it is presented too late and in the wrong forum.

The District Court believed that the use of the Corporation's loss as a deduction from income in the consolidated returns was not intended by the revenue laws. Appellants and appellees are agreed that the returns were proper under the tax laws and that the settlement of tax liability with the Government was also proper. In either view of the intent of the revenue laws, the Corporation's claim must fail. If it be assumed that the use of the Corporation's loss to offset taxable income resulted in an under-payment of taxes to the United States, no right would on that account vest in the Corporation. Alternatively, if the "tax saving" was intended by the revenue laws and the taxes due the United States were fully paid, the Corporation is merely attempting to assert, without justification, a claim to a portion of the income earned by and belonging to the reorganization trustees.

There is a well recognized and generally accepted formula for settling intra-group affairs in connection with consolidated returns. It calls for an apportionment of the consolidated tax in proportion to taxable incomes with no "tax saving" payment. The Securities and Exchange Commission has by rule established that formula for the utility industry. The Treasury Department has approved it. It is generally employed by the business community and it has been followed without deviation for twenty years by the Western Pacific group at the direction of the Corpo-

ration itself. Appellants are attacking a practice which has been followed without challenge since the income tax laws were first enacted. Their position has never been approved and it has been specifically condemned.

Appellants' case lacks the fundamentals of any legal action: proof of wrong and proof of damage. The entry of the loss of the Corporation as a deduction from income in the consolidated returns did not affect the Corporation nor damage it in any way. It paid no taxes under the consolidated returns. It would have paid none under separate returns.

Appellants have no unjust enrichment claim. In law the trustees were not "enriched" by retaining income they had earned in operating the railroad properties. Even if this were an enrichment, it was not unjust to appellants. The failure of appellants to show injustice *to them* is fatal to their claim. Moreover, under the circumstances of this case, any unjust enrichment recovery, even if a claim could be made out, would necessarily be nominal. Against a defendant whose conduct has not been tortious or wrongful (and certainly *these appellees* are guilty of no wrong) judgment for unjust enrichment is limited to the gain to the defendant or the loss to the plaintiff, *whichever is the lesser*. In this case the plaintiff suffered no loss.

The dual employment of the personnel who handled the tax transaction is of no significance. Duality in itself is not a wrong, nor does it give rise to liability in the absence of wrong. Moreover, if, as appellants argue, they are entitled to "fairness" they still have no claim. The best proof of "fairness" is the twenty years of past practice of the Corporation itself, the settled practice of the business community and the conclusion uniformly expressed by all who have considered the problem of intra-group practices in connection with consolidated returns—all of which are in strict accordance with what was done in this case and directly opposed to what appellants seek to have done.

In this equity proceeding appellants are without equity. The present owners of the reorganized company are the secured creditors (and their successors in interest) of the old company. The claims of those creditors have never been paid in full. The stock and other securities which they received in the reorganization have never been equal in value to their claims against the old company. The Corporation, as parent company, owed fiduciary duties to these creditors of its subsidiary. It was obligated to protect their interest, either by joining in consolidated returns or otherwise. Certainly, as fiduciary, the Corporation cannot be allowed to reduce the assets of the reorganized company by \$17,000,000 and thus further diminish the already inadequate recovery of the secured creditors of its subsidiary.

Appellants' claim, even if it had substance, cannot be asserted against appellees. The taxes which were "saved" were taxes of the reorganization trustees; a claim for the "saving" is a claim against those trustees. The trustees, however, are not parties to this action and the assumption agreement by which the reorganized company undertook to pay certain trustee obligations does not include this claim. Even if appellants had a claim against the reorganization trustees, they have none against appellees.

Appellants' claim is barred by the failure to present it during the reorganization proceeding. The "tax saving" claim, if paid, would have been an expense of administration of the reorganization proceeding. Such expenses have validity and can be paid only if they are approved and allowed by the reorganization court. This claim was neither presented to, approved by nor allowed by that court.

The principal purpose of the reorganization would be frustrated if appellants were allowed judgment for \$17,000,000 against the reorganized company (an amount nearly twice the authorized first mortgage bond issue of the reorganized company) on the basis of a claim relating to the period of reorgan-

ization but which was neither advanced nor considered in that proceeding. Any such judgment would frustrate the purpose of the reorganization; it would repudiate the conclusion of the Supreme Court that appellants' interest in the Western Pacific group was valueless; and it would be in derogation of the provisions of the reorganization decrees barring all claims not specifically approved and allowed.

Argument

I. APPELLANTS HAVE NO CLAIM.

By this litigation appellants seek a retrospective examination of the proceedings taken in connection with the income and excess profits taxes of the reorganization trustees of The Western Pacific Railroad Company. The tax proceedings were carried on in a routine, open fashion according to procedures which had been followed for many years. The reorganization court, the trustees and all who participated in the tax proceedings understood that there was a possibility that the Government would not accept the returns as filed and, accordingly, a tax reserve was created. The possibility that the Corporation might assert a claim occurred only to the attorney for the Corporation, who consulted expert tax lawyers in that connection. They gave him no encouragement. Some years later, after the reorganization was completed and closed, certain stockholders of the Corporation brought a suit in which the claim made here was asserted for the first time. Shortly thereafter the Corporation filed this action. The District Court observed that the claim is novel and bizarre and that it is an afterthought pursued on account of the large amount involved. These facts are not recommendations for appellants' claim, but since it is earnestly pressed, this brief points out some of its defects.

The first question is: Does the fact that the entry of the Corporation's loss in the consolidated returns reduced the taxes of the reorganization trustees vest a money claim in the Corporation? If it does not, if the Corporation has been deprived of nothing to which it is entitled, arguments about fairness, duality and fiduciary obligations are all irrelevant.

Consolidated returns have been filed in great numbers since the early years of the income tax law. One consequence is that specific and dependable guides for the proper settlement of intra-group liabilities in connection with those returns are now available. They are

The past practice of the parties and the general practice of the business community.

The rulings of the Securities and Exchange Commission and the Treasury Department.

The studies of affiliated groups by the Federal Trade Commission and the decisions of the Interstate Commerce Commission.

These, the relevant guides for decision, unlike appellants' arguments,¹¹ all relate precisely to the matter in hand. They demonstrate that the decision below is in accordance with all the precedents and settled practice. In attacking those precedents and that practice appellants fail to prove a cause of action.

A. Appellants Have No Claim Based on the Failure, if Any, to Pay Taxes Due the United States.

Appellants claim moneys which were earned by the reorganization trustees in the operation of the railroad properties. The

¹¹Appellants cannot agree on what this Court should do or why it should do it. The Corporation wants judgment for \$17,201,739.00; the interveners will be content with what "to this Court may appear fair in the circumstances of this case" (In. Br. p. 69). The Corporation stresses unjust enrichment; the interveners stress duality. The Corporation says little about a possible bargain with the trustees; the interveners place heavy emphasis on the bargain idea. Nothing which appellants say, however, furnishes any justification for overturning the settled practice of the parties.

court below concluded that those moneys belong either to appellees as railroad revenues or to the United States as taxes—and that in neither event do appellants have a claim. The court also thought that the tax result reached here was contrary to the intent of the revenue laws and that no "tax saving" should have occurred. The trustees paid no tax on large amounts of income as a result of a literal application of I. R. C. Sec. 23(g) (4) to the circumstances here presented. That section permits the loss to a taxpayer corporation when the stock of an affiliated corporation becomes worthless in its hands to be treated for tax purposes as an ordinary loss rather than a capital loss and hence available as an offset to ordinary income. Normally, however, the taxpayer's loss on the stock of an affiliate offsets income of the taxpayer or another affiliate. Here the loss offset for tax purposes the income of the properties of the very company whose stock was declared worthless. This result followed, however, from the express language of the statute. But because of the uncertainty as to the year of loss,¹² an uncertainty as apparent to the Bureau as to the taxpayer,¹³ a settlement was made whereby the United States accepted \$4,201,821.54 in full discharge of the group tax liability for the period in question.

The court below believed that the Bureau exercised poor judgment in accepting this compromise. Appellees disagree. If, however, this Court should share the view of the District Court on this aspect of the case, it must inevitably reach the same conclusion: that appellants have no claim on tax moneys. Appellants are not tax collectors. To prevail they must establish their own rights. They cannot rely on the rights of the United States. "Re-

¹²The Bureau argued initially that the loss related back to the initial approval of the reorganization plan in August 1940 and that it was therefore a 1940 loss and not available to offset 1943 income (R. 1423-26).

¹³The record demonstrates that the Bureau representatives had complete and detailed information on all aspects of the tax transaction. See R. 1418-20, 1423-30, Ex. P. 64, R. 1779.

spondents, to have standing in court, must show an injury or threat to a particular right of their own, as distinguished from the public's interest in the administration of the law." *Perkins v. Lukens Steel Co.*, 310 U.S. 113, 125, 60 S.Ct. 869, 876 (1940); *Stark v. Wickard*, 321 U.S. 288, 304, 64 S.Ct. 559, 568 (1944).

B. Appellants Have No Claim Based on Unjust Enrichment, Fiduciary Obligations or Duality.

The briefs of appellants discuss doctrines of unjust enrichment, fiduciary obligation and duality. Those doctrines provide, however, no support for appellants' claim.

1. APPELLANTS HAVE SUFFERED NO WRONG AND PROVED NO DAMAGE.

Appellants do not prove a cause of action. They have no title claim. The funds they seek came from shippers in exchange for transportation service. They have never belonged to appellants. With no title to assert appellants, as other litigants, must prove that they have been wronged and damaged. They prove neither. In 1943 the courts gave formal recognition to the financial truth that over the years the interest of the Corporation in the old company had become worthless. Congress authorized a tax calculation whereby an entry was made in consolidated returns deducting the amount of the Corporation's loss from the income figures appearing in the returns. Returns thus prepared were filed and audited and the group liability was compromised and satisfied. Nothing in this process constituted a wrong to appellants. They suffered no tort; no contract was breached; no statutory right was infringed. Appellants have, therefore, no standing in court. "The only injury of which plaintiffs may complain in a judicial tribunal is the invasion of some legal or equitable right." *Tilney v. City of Chicago*, 134 F.2d 682, 683 (C.C.A. 7, 1943) cert. den, 320 U.S. 759.

Nor have appellants been damaged. The Corporation paid no tax under the consolidated returns (Ex P. 3A/B, 4A/B, 5A/B)

just as it would have paid no tax under separate returns. (Ex. D. 46, R. 2040) The reference in the returns to the fact of its loss cost the Corporation nothing. The Corporation had no income (Exs. D. 40, D. 46, R. 2040). It could not have used the loss itself¹⁴ and it could not have sold it.¹⁵ The Corporation has thus proved no damage and without proof of damage no litigant can recover. "The damages recovered by an injured party have always been limited to his 'actual damages'." *Connecticut Ry. Co. v. Palmer*, 305 U.S. 493, 504, 59 S.Ct. 316, 323 (1939). "Wrong without damage or damage without wrong does not constitute a cause of private action * * *." *Clark Oil Co. v. Phillips Petroleum Co.*, 148 F.2d 580, 582 (C.C.A. 8, 1945), cert. den, 326 U.S. 734.

2. APPELLANTS HAVE NO UNJUST ENRICHMENT CLAIM.

Nothing in the law of unjust enrichment suggests that appellants have a claim. The failure of the reorganization trustees to pay additional taxes was not, in contemplation of law, an enrichment. Even if it were, the enrichment was not unjust to appellants and without proof of injustice to *them* appellants cannot recover. Finally, where, as here, the defendant is not a wrongdoer unjust enrichment recovery can never exceed the actual loss to the plaintiff—in this case, nothing.

(i) Appellees Were Not "Enriched."

If separate returns had been filed for the years in question, or

¹⁴The consolidated returns and the refund claim applied only a portion of the stock loss against income of the reorganization trustees. From the balance of the loss amounting to more than \$42,000,000 (Ex. D. 40, D: 52A) appellants have not been able to derive any gain whatever—proof positive that no damage has been suffered.

¹⁵In *J. D. and A. B. Spreckels Co. v. Commissioner*, 41 B.T.A. 370 (1940), the taxpayer had acquired the stock of a subsidiary in order to take advantage of a tax loss which the subsidiary was about to realize. The loss was taken and the taxpayer sought to claim the loss as a deduction in a consolidated return. It was held that since the acquisition of the stock had no business purpose the loss could not be allowed.

if there had been no reference in the consolidated returns to the Corporation's loss, the trustees would have paid additional taxes. The difference would not have been \$17,201,739.00 as appellants suggest and the District Court assumed, but some substantially smaller figure, the exact amount of which is highly uncertain.¹⁶ But whatever the proper calculation, a "saving" of taxes is not an "enrichment." Congress expects that the deductions provided for by the Revenue Acts will be taken. "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether avoid them, by means which the law permits, cannot be doubted." *Gregory v. Helvering*, 293 U.S. 465, 469, 55 S.Ct. 266, 267 (1935).¹⁷

¹⁶Since there is no such thing as a "normal" tax (see footnote 23 in Part VI of Securities and Exchange Commission Release No. 53, Accounting Series, November 16, 1945), the computation of any so-called "tax saving" requires a comparison between the tax actually paid and a hypothetical tax which might have been paid. A calculation of the amount of the alleged "tax saving" here involved requires such a comparison between the actual tax and a hypothetical tax which the reorganization trustees would have paid if the Corporation's stock loss had not been available as a deduction. The computation and amount of the hypothetical tax were debated at length at the trial, both orally and upon brief. Tax experts were called as witnesses by both sides (R. 911-955; 1501-1576; and 1583-1585), and they disagreed by several millions of dollars as to the proper computation. In fact, the appellants' own expert presented three alternative and widely varying computations (Ex. P. 80, R. 1825-1829). Among the questions to be decided in determining the hypothetical tax are the following: (a) Should the hypothetical tax be computed on consolidated or separate returns? (b) How should the loss carry-overs and unused excess profits credits of the reorganization trustees be treated? (c) Should intercompany interest accruals and other intercompany transactions be considered? (d) What effect should be given to the accelerated amortization deductions, the freight refunds and the government's pending freight reparation claims? (e) Should alternative tax saving methods be taken into account? (f) Should effect be given to the partial worthlessness of the large debt owed to the reorganization trustees by Sacramento Northern Railway? Each of these is a difficult and complex problem which must be solved before the amount of the hypothetical tax can be properly computed. The trial court concluded, however, that the appellants were not entitled to any part of the tax saving and consequently the court had no occasion to determine its amount or to consider or decide any of the problems involved.

¹⁷For a criticism by the Securities and Exchange Commission of the entire concept of a "tax saving" see Appendix B, p. 7.

(ii) Assuming An Enrichment, It Was Not Unjust to Appellants.

Even assuming that a lawful calculation of taxes could be called an "enrichment," and assuming, further, that the benefit to the trustees was brought about by the Corporation, appellants still have no claim. "The mere fact that a person benefits another is not of itself sufficient to require the other to make restitution therefor." (*Restatement of Restitution*, Sec. 1, p. 13.) "But, in order to establish unjust enrichment it is not enough merely to show one's retention of the benefit. The retention must also be unjust." *Bailis v. R.F.C.*, 128 F.2d 857, 859 (C.C.A. 3, 1942). The instances in which a plaintiff has conferred a benefit on a defendant and failed to obtain judgment are legion.¹⁸ To succeed, a plaintiff must prove injustice to him. The doctrine is a doctrine of restitution. The plaintiff must show that something was taken from him and that there is some recognized basis—fraud, mistake, duress, undue influence, illegality—for revoking the transfer.

One consequence is that in every windfall situation, such as ap-

¹⁸The cases include (a) cases where, as in this case, there has been a long course of dealing without payment, see *Country Club District Service Co. v. Edina*, 8 N.W.2d 321 (Minn. 1943), *Wright v. Sheldon*, 53 Atl. 59 (R.I. 1902); (b) cases where, as in this case, there has been a mutual exchange of benefit, see *Potter v. Carpenter*, 76 N.Y. 157 (1879), *Allen v. Bryson*, 25 N.W. 820 (Iowa 1885), *Gross v. Cadwell*, 30 Pac. 1052 (Wash. 1892); (c) cases where, as in this case, the enrichment of defendant cost plaintiff nothing, see *Boston v. District of Columbia*, 19 Ct. Cl. 31 (1883), *Erickson v. Hochbrune*, 91 Pac. 485 (Wash. 1907); and (d) cases in which services were performed or a benefit transferred under circumstances in which the defendant did not expect to pay even though the plaintiff expected to receive compensation, see *Concord Coal Co. v. Ferrin*, 51 Atl. 283 (N.H. 1901), *Peters v. Adams*, 190 N.Y.S. 220 (Cty. Ct. 1920), aff'd 188 N.Y.S. 945 (App. Div. 1921), *Dusenka v. Dusenka*, 21 N.W.2d 528 (Minn. 1946).

If the claim in this case is in reality a claim for service by the Corporation in assisting the trustees in protecting the railroad properties against demands for taxes, no compensation may be required of appellees for the reason, among others, that in view of the past practice, in which no payment was made for the use of losses, the trustees could not have expected to make any such payment.

pellants claim this to be, the defendant prevails. In *Straube v. Bowling Green Gas Co.*, 227 S.W.2d 666 (Mo. 1950), plaintiffs paid for gas at rates based upon charges made to the gas company by its suppliers. During litigation over the validity of an order reducing the rates of the supplier the difference between the new and the old rates was impounded and later paid to the gas company. Plaintiffs' unjust enrichment argument failed. "Since the facts alleged show no 'unjust privation' of appellants and no legal or equitable rights in appellants as to either fund, there could be no 'unjust enrichment' of respondent at the expense and loss of appellants." (227 S.W.2d 671). In *Houck v. Hubbard Milling Co.*, 167 N.W. 1038 (Minn. 1918), the defendant received refunds resulting from revision of freight rates. Plaintiff, who had made sales to defendant on the assumption the existing rates were to apply, attempted to claim the refunds. "The refunds amount to a find for the defendant. * * * No legal equity puts a right of recovery in the plaintiff." (167 N.W. 1039.) In *Consolidated Cut Stone Co. v. Seidenbach*, 114 P.2d 480 (Okla. 1941), subcontractors gave the owner certain credits on account of defaults of the general contractor. A surety later compensated the owner for the same defaults. The subcontractors, arguing unjust enrichment, attempted without success to obtain judgment in the amount of the credits. "Unless these appellants had rights existing prior to or at the time payment was made * * * which were violated or altered by the payment, the mere fact of excess payment can give them no right." (114 P.2d 484.) In *Greek Catholic Congregation of Borough of Olyphant v. Plummer, et al.*, 32 A.2d 299 (Pa. 1943), plaintiffs failed to recover from defendant royalties which defendants had received on coal which belonged to plaintiffs. "In every case of 'unjust enrichment' the courts have been able to point out some wrong done by the party enriched. By 'wrong' is meant, of course, the violation of another's legal right." (32 A.2d 300.) In *Russo v. Hosmer, Inc.* 44 N.E.2d

641 (Mass. 1942), Hosmer was paid by Massachusetts for work he had illegally contracted to Russo who sought relief in quantum meruit. Russo's claim was denied. "He [Russo] was not damaged nor affected by the failure to observe the provisions in Hosmer's contract with the Commonwealth governing the subletting of the work." (44 N.E.2d 644) In *Vanderbilt University v. Williams*, 280 S.W. 689 (Tenn. 1926) defendant received rent for land over which he and plaintiff had identical easements which entitled neither to rent payments. Plaintiff's claim for half of the rent was denied: "Equity may not be invoked to supply a remedy until a right, legal or equitable, exists." (280 S.W. 692.)

Thus the cases make it clear that a windfall to appellees vests no claim in appellants unless appellants can demonstrate injustice to them by an invasion of rights which the law recognizes. The rights of appellants have not been invaded. They cannot recover.

(iii) Appellants' Unjust Enrichment Recovery Could Not in Any Event Exceed the Actual Loss to Them.

The law of unjust enrichment recognizes three situations: (a) that in which the defendant is free from fault; (b) that in which the conduct of defendant is tortious; and (c) that in which the defendant is a conscious wrongdoer. If the defendant is free from fault, the judgment, assuming a case is made out, is limited to the loss to the plaintiff or the benefit to defendant, *whichever is lower*. "If the [defendant] was no more at fault than the claimant, he is not required to pay for losses in excess of benefits received by him and *he is permitted to retain gains which result from his dealing with the property.*" (*Restatement of Restitution*, p. 596 and see the illustrations, pp. 356 and 618.)

The cases agree. A surety, for example, who pays an obligation of his principal at a cost to the surety less than the obligation discharged can recover only his outlay. If, for instance, he

pays the principal's debt in depreciated currency, he recovers only the cost of the currency to him.¹⁹

If, therefore, appellants' case rests upon unjust enrichment, appellants can at most demand no more than a nominal judgment. Plainly there was nothing wrongful in the handling of the tax transaction. The Internal Revenue Code provides for consolidated returns; the stock loss deduction is within the plain language of Section 23(g)(4); liabilities within the group were determined in accordance with the formula universally recommended and which the parties had followed for twenty years. Taxpayers who follow twenty years of past practice and the unanimous precedents are not conscious wrongdoers or tortfeasors. Unjust enrichment recovery could not, therefore, exceed in any event the gain to appellees or the loss to appellants, *whichever is lower*. Appellants suffered no loss; they can have no judgment.

3. APPELLANTS HAVE NO CLAIM ARISING FROM FIDUCIARY OBLIGATIONS.

Appellants attempt to support their position by contending that fiduciary obligations were operating in favor of the Corporation in connection with the tax transactions. The argument is unsound. In those transactions the Corporation was itself charged with fiduciary duties and its position was in no respect that of a cestui que trust.

(i) The Corporation Was Charged with Fiduciary Obligations.

The taxes under discussion are taxes for a period in the trusteeship prior to May 1, 1944, a period when the Corporation was

¹⁹See, for example, *Bonney v. Seely*, 2 Wend. 481 (N.Y. 1829): "If the plaintiff had paid the defendants' debt by paying half the amount, can he recover the whole from the defendants? I think not. He is entitled to recover the amount paid, not the amount extinguished by that payment." See also *Kendrick v. Forney*, 22 Gratt. 748 (Va. 1872); *Butler v. Butler's Administrator*, 8 W. Va. 674 (1873); *Succession of Dinkgrave*, 31 La. Ann. 703 (1879); *Hall v. Creswell*, 12 Gill & Johnson 26 (Md. 1841).

the sole stockholder of the old company. As parent, the Corporation had fiduciary responsibilities to its subsidiary and particularly to the subsidiary's creditors, the present stockholders of appellees. "A holding company * * * has fiduciary duties to security holders of its system which will be strictly enforced." *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 522, 61 S.Ct. 675, 683 (1941). "* * * Inland, by reason of its entire ownership and control of Michigan, occupied a fiduciary position requiring scrupulous observance of its obligations to safeguard and preserve the interest of Inland bonds, and owed to its bondholders, a duty not to impair the value of the Michigan stock." *In re Commonwealth Light & Power Co.*, 141 F.2d 734, 736 (C.C.A. 7, 1944). See, also, *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 68 S.Ct. 1454 (1948). The fact that the returns were physically filed after the Corporation surrendered its stock does not affect the Corporation's obligations. The returns related to the period of affiliation and the obligations of the parties with respect to them were therefore the obligations of the affiliation period. The obligations of a fiduciary upon termination of the relationship continue unimpaired with respect to all past transactions and the incidents of winding up. The rule applies to all fiduciary relationships: partnerships, agencies, trusts and corporate affairs.²⁰ The Corporation had, therefore,

²⁰*To Partnerships*: "On dissolution the partnership is not terminated, but continues until the winding up of partnership affairs is completed." Uniform Partnership Act, 7 U.L.A. Sec. 30; Cal. Corp. Code Sec. 15030.

To Agencies: "The duty of an attorney to be true to his client, or of an agent to be faithful to his principal, does not cease when the employment ends, and it cannot be renounced at will by the termination of the relation. It is as sacred and inviolable after as before the expiration of its term." *Trice v. Comstock*, 121 Fed. 620, 625 (C.C.A. 8, 1903).

To Trusts: "When the time for termination of the trust has arrived, the duties and powers of the trustee do not immediately cease, but until the trust is actually wound up, he has such duties and powers as are appropriate for the winding up of the trust." 3 *Scott on Trusts* (1939) Sec. 344.

To Corporations: "* * * by statute in most jurisdictions it is now provided that upon the dissolution of any corporation in any manner, or upon

fiduciary obligations with respect to the tax transactions which were entirely unaffected by the date the returns happened to be filed. Those fiduciary duties required that the Corporation cooperate in minimizing taxes for the benefit of the unpaid creditors of the old company, the present stockholders of appellees. As fiduciary, the Corporation was not entitled to prefer its own interest over the interest of those unpaid creditors by demanding a "tax saving" payment of \$17,000,000.00 on account of an entry in the tax returns which cost the Corporation nothing. The fiduciary obligations which the law recognizes for the circumstances of this case do not support the claim of appellants; they support the judgment below.

(ii) The Position of the Corporation Was Not That of a Cestui Que Trust.

Appellants seek to reverse the fiduciary obligations imposed by law and place the Corporation in the position of a cestui que trust by an attack upon the Corporation personnel who handled the tax transactions. The fact is, however, that the officers and directors of the Corporation were both competent and informed. The directors included Mr. Schumacher, "a very experienced railroad man" (R. 1231) characterized by counsel for appellants as a man "of great ability and great honesty of character" (R. 993); Mr. Wood, a man thoroughly experienced in large financial affairs (R. 1122-23) and who had special experience in reorganization matters (R. 1123); two well qualified New York lawyers, Mr. Osborn and Mr. Campbell, each of whom are of counsel for the Corporation in this case; and Mr. Curry, president of the Corporation, described by the court below as "a perfectly competent man, intelligent, and probably a pretty good railroad man" (R. 785). As lawyers the Corporation had, for the reorganization proceeding, Judge Sloss of San Francisco, whose competence and integrity

the expiration of its period of corporate existence, the directors at the time of the dissolution shall be the trustees of the creditors and stockholders of the corporation * * *." 16 Fletcher, *Corporations* (Perm. Ed.) Sec. 8174.

are beyond question (R. 1600-03), and as general counsel, Pierce & Greer, counsel in this case, who for thirty years have represented large railroad organizations (R. 1030) who were actively prosecuting various claims on behalf of the Corporation during the period in question, including another suit against these appellees (R. 1048-52) and whose senior partner, Mr. Nicodemus, was sufficiently experienced in tax matters to be chairman in 1943 of a special tax committee organized by the railroads (R. 1034-35). As an unimpeachable source of information the Corporation had the fact that the tax returns were prepared in its office (R. 829-30, 844-46, 1258-59, 1414) as long as the office was open (R. 891, 1287) and signed and filed by its president (R. 663-66, 831, 837). The Corporation had, in addition, Mr. Polk's oral report on tax affairs to Mr. Curry and Mr. Nicodemus on May 18, 1943 (R. 839, 1079-80), Mr. Polk's letter of May 20, 1943 (Ex. P. 50, R. 1757) reviewing the tax situation, the annual reports of the trustees which discussed tax problems (Exs. 20-B, 20-C, R. 511-14, 1279) and the hearing held by the reorganization court reviewing the tax situation and establishing a tax reserve (R. 1991, 703, 1085).²¹ Mr. Curry, Corporation president, who had handled tax matters for the Western Pacific group for many years (R. 841-45)

²¹The petition of the trustees for an order to establish a reserve fund of \$7,100,000 for contingent tax liabilities was filed on February 21, 1944 (Ex. P. 58, R. 1772). Judge St. Sure, by an order dated February 21, 1944, set March 3, 1944, as the date for a hearing on the petition and specifically required the trustees to give notice to and send a copy of the petition and the order setting the date of the hearing to the Corporation (Ex. D. 28, R. 1991). On March 3, 1944, a hearing on the petition was held during which Mr. Elsey testified substantially as indicated by Ex. D. 34 (R. 2023): that under consolidated returns the plaintiff's loss would offset trustee income, but that until the returns were accepted by the Bureau of Internal Revenue there was a possibility of litigation resulting in a substantial tax liability, and thus that the trustees deemed it prudent to establish a reserve for contingent tax liability in the amount indicated (R. 1271-74). By its order of March 3, 1944, the bankruptcy court authorized the trustees to establish the fund (Ex. D. 12, R. 1895). In connection with 1944 taxes the reserve was later increased to a total of \$10,100,000 (Exs. P. 20C, P. 20D, R. 515-16).

and who appreciated the difference between consolidated and separate returns (Ex. D. 56, R. 2087-90), thoroughly understood the tax situation and wrote to Mr. Nicodemus explaining it (Ex. In. 5, R. 2125); Mr. Schumacher was familiar with the tax transactions throughout (R. 876-77); Mr. Osborn, another director, knew that consolidated returns were being filed (R. 1019) and that they conferred substantial benefits on the trustees (R. 1020-22); Mr. Wood had no doubt that consolidated returns would be filed (R. 1132-3). The possibility of a "tax saving" claim for the Corporation occurred to Mr. Nicodemus, Corporation counsel, and he discussed it with three prominent tax lawyers, Thomas Tarleau, who had recently been legislative counsel for the Treasury (R. 1059), Leslie Rapp, formerly minority clerk of the House Ways and Means Committee (R. 1059-60) and Claude Dudley, who was associated with Mr. Nicodemus in his efforts to obtain favorable tax legislation from Congress (R. 1063). Mr. Dudley, like Mr. Polk (R. 1433), Mr. Elsey (R. 1285), Mr. Ehrman (R. 1240-42) and the prominent tax specialists who offered to testify on the call of appellees (R. 1586-95),²² had never heard of any such claim (R. 1063). Mr. Tarleau and Mr. Rapp said the idea had no merit (R. 1062-63). Although the Corporation had no financial interest in the tax negotiations since it would pay no taxes in any event (Ex. D. 46, R. 2040), it had, nevertheless, control over the tax transactions. The returns could not be filed except as they were signed and filed by the Corporation (Treas. Regs. 104, Sec. 23.16). The trustees, who had the financial interest, hired and paid tax counsel (Ex. D. 39-E, R. 1746, 1233), but Mr. Polk gave only advice (R. 1403, 1414, 1415, 1417); he did not make decisions. The final decisions were necessarily made by the Corporation when it filed the returns. In the tax trans-

²²This testimony was excluded as unnecessary and irrelevant (R. 1593) and appellants objected successfully when Mr. Coulson was asked whether he had ever heard of any such claim (R. 1498-1500).

actions the Corporation suffered no abuse; its personnel were competent and informed; its decisions were deliberate and supported by twenty years of past practice.

Incompetence on the part of Corporation personnel would not in any event either relieve the Corporation of its fiduciary duties or impose fiduciary duties on others in the Corporation's favor. A fiduciary cannot avoid his responsibilities by lack of capacity. Nor can he, by complaining of his disability, impose those responsibilities on others. The Corporation as holding company and as a member of the group had fiduciary duties in the tax transactions. Those duties bound the Corporation whoever its officers and directors might be. They were binding, moreover, on anyone who took charge of or participated in the tax transactions. Even if it were the fact, which it is not, that the trustees or their lawyers took charge of tax matters the consequence would be only that the trustees and their lawyers, to the extent they acted for the Corporation, would be obligated to honor the fiduciary duties of the Corporation.

Those fiduciary duties, moreover, are not defined, as appellants seem to believe, by the rules which apply to formal trusts. Fiduciary obligations in connection with corporate affairs are those which are appropriate for that purpose. They are not those which relate to express trusts. *Manufacturers Trust Co. v. Becker*, 338 U.S. 304, 311, 70 S.Ct. 127, 132 (1949).²³ As far as consolidated returns are concerned they are best defined by the past practice of the group and all the precedents, all of which are in accordance with what was done and opposed to what appellants claim should have been done.

²³Compare *Securities and Exchange Commission v. Chenery Corp.*, 318 U.S. 80, 85, 63 S.Ct. 454, 458 (1943): "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

Nothing which occurred in connection with taxes relieved the Corporation of its normal fiduciary duties to its subsidiaries and their creditors. Nothing imposed fiduciary duties on those subsidiaries in favor of the Corporation. The position of the Corporation was in no sense the position of a cestui que trust. There was no trust, no trust res, and no trust obligation running to the Corporation. A discussion of fiduciary duties in this case serves only to support the judgment below. The decisions of the Supreme Court make it clear that a fiduciary obligation ran from the Corporation to the unpaid creditors of its subsidiary. The decision below refusing to permit the Corporation to prefer its interest over the interest of those creditors is in accordance with that obligation.

4. APPELLANTS HAVE NO CLAIM ON ACCOUNT OF DUALITY.

The intervener appellants emphasize that the Corporation officers who handled the tax transaction were also employed by the old company and by the trustees. This duality is of no assistance to appellants. The doctrine even in a general sense has no application here; duality in any event is not a wrong and of itself it creates no rights; and, finally, nothing which was done was in fact unfair to appellants.

(i) The Duality Doctrine Has No Application Here.

First. The Corporation cannot complain of a duality which it created for its own purposes. The dual employment of Western Pacific personnel came about at the direction of the Corporation (this brief p. 3); the trustees assumed the expense of the joint New York office at the Corporation's specific request (this brief p. 6). The Corporation cannot now complain. "* * * when appealing to a court of equity for the enforcement of his rights against others the plaintiff should not himself be responsible for the condition of which he complains." *Myers v. Louisiana*

& A. Ry. Co., 7 F. Supp. 97, 99 (W.D. La. 1934); *Rosaly v. Gonzales*, 106 F.2d 169, 172 (C.C.A. 1, 1939).

Second. Duality between the Corporation and the officers of the reorganization court is of no significance. The pay from the reorganization trustees did not impose an obligation on the officers of the Corporation inconsistent with their obligations to their company. The trustees had no personal interest in the reorganization. *In re Ducker*, 134 Fed. 43 (C.C.A. 6, 1905). Their only purpose was to see that all approved claims were paid. There was, therefore, none of the conflict of interest upon which the duality rule depends. "Here we are dealing with officers of the court and directors appointed by them, men of standing, ability and integrity. There is here no room for any reaction of prejudice or bias, conscious or otherwise, to the frailties of human nature * * *" *J. C. F. Holding Corp. v. General Gas & Electric Corp.*, 46 N.Y. S.2d 605 (1943). Moreover, the Bankruptcy Rules themselves demonstrate that duality in connection with a reorganization proceeding is not a significant circumstance. General Order 44 contains a special provision authorizing the court in a railroad reorganization proceeding to employ attorneys associated with the debtor. Duality does not affect the course or finality of a reorganization proceeding. *Duryee v. Erie R. Co.*, 175 F.2d 58 (C.A. 6, 1949) cert. den. 338 U.S. 861.

Third. The duality cases do not criticize a transaction conducted in accordance with what prudent and independent persons would have done under the circumstances *Hellier v. Baush Machine Tool Co.*, 21 F.2d 705, 707 (C.C.A. 1, 1927); *International Radio Telegraph Co. v. Atlantic Communication Co.*, 290 Fed. 698, 702 (C.C.A. 2, 1923) without benefit of hindsight *Blaustein v. Pan American Petroleum & Transport Co.*, 56 N.E.2d 705, 715 (N.Y. 1944); *Crawford v. Mexican Petroleum Co. of Delaware*, 130 F.2d 359, 362 (C.C.A. 2, 1942). The tax transaction was handled in strict accordance with twenty years of past

practice of the group, with the general practice of the business community and with all the relevant precedents. Presumably, therefore, any prudent person would have done precisely what was done. The courts will not interfere. *Hellier v. Baush Machine Tool Co.*, supra; *International Radio Telegraph Co. v. Atlantic Communication Co.*, supra.

Fourth. Appellants have failed to make a case under the duality doctrine itself. Thus far appellants have no suggestion as to what "fairness" requires. In the cases upon which appellants rely the courts were not thus left without assistance. There was in the record evidence of market value *Geddes v. Anaconda Copper Mining Co.*, 254 U.S. 590, 600-02, 41 S.Ct. 209, 213 (1921); *De Lamar Mines of Montana v. Mackay*, 104 F.2d 271, 275 (C.C.A. 9, 1939) or some other established guide to fairness *Espach v. Nassau & Suffolk Lighting Co.*, 31 N.Y.S. 2d 259, 264-5 (1941), aff'd *sub nom. Chelrob v. Barrett*, 57 N.E.2d 825 (N.Y. 1944) to which the court could turn. Appellants offer nothing. All the past practice and all the precedents are contrary to their position.

Fifth. Duality as such proves nothing. It creates no rights. Its existence does not constitute a wrong. Appellants, having asserted duality, have yet to prove their claim. "It is not mere existence of an opportunity to do wrong that brings the rule into play; it is the unconscionable use of the opportunity * * *." *Comstock v. Group of Institutional Investors*, 335 U.S. 211, 229, 68 S.Ct. 1454, 1463 (1948); *Leavenworth County Commissioners v. Chicago, Rock Island & Pacific Ry. Co.*, 134 U.S. 688, 705, 10 S.Ct. 708, 714 (1890); *Skelly v. Dockweiler*, 75 F. Supp. 11, 14 (S.D. Cal. 1947); *Everett v. Phillips*, 288 N.Y. 227, 236, 43 N.E.2d 18, 22 (1942). Appellants do not prove a claim by an appeal to a general doctrine of "fairness" unsupported by evidence as to what "fairness" requires.

(ii) Appellants Have No Claim Based on a Hypothetical Bargain.

Intervenors argue in effect that this Court should make a retrospective bargain between the reorganization trustees and the Corporation and enforce it against appellees (In. Br. p. 49). This asks the impossible.

First. This Court has no power to exercise bankruptcy jurisdiction to make a bargain for appellants. The reorganization trustees are not parties to this proceeding and cannot be made parties. The Court can hardly bargain for them in their absence. Moreover, jurisdiction over those trustees is vested not in this Court but in the bankruptcy court and the jurisdiction is exclusive. *U. S. Fidelity & Guaranty Co. v. Bray*, 225 U.S. 205, 217, 32 S.Ct. 620, 625 (1912); *Isaacs v. Hobbs Tie & T. Co.*, 282 U.S. 734, 739, 51 S.Ct. 270, 272 (1931).

Second. The bargain which the intervenors demand would have destroyed the tax saving. Under the Internal Revenue Code a loss on the worthlessness of stock is a tax deduction only if the stock is completely worthless.²⁴ If a stock otherwise worthless has any element of value attached to it, worthlessness is not established and the loss cannot be taken either in whole or in part.²⁵

The Corporation's position in the tax transaction resulted solely from the fact that it owned the stock of the old company. Any

²⁴Treas. Reg. 111, Sec. 29.23(e)-4 (I.R.C.). 5 Mertens, *Law of Federal Income Taxation* (1942) pp. 256-57.

²⁵I.T. 3252 [1939—I Cum. Bull. 182] is the Treasury's response to a request for advice on this situation. In 1936, A agreed to buy from the M Company certain stock of the O Company. In 1937, A paid a portion of the purchase price. In that year the stock definitely became worthless. A, however, was obligated to complete payment for the stock. The question was whether the M Company could deduct for tax purposes its loss on account of the worthlessness of the stock. The answer was no: "It is further held that inasmuch as the M Company holds A's contractual obligation to pay to it the sum of 5x Dollars for the stock (being the cost of such stock to the M Company), these particular shares of stock are not worthless in its hands and, therefore, it is not entitled, for Federal income tax purposes, to deduct from its gross income for the year 1937 any part of its investment in such shares of stock."

payment made to the Corporation or any agreement for such payment would itself demonstrate that the stock had an element of value, an element of value measured precisely by the payment. The stock would not, therefore, be totally worthless and the deduction could not be taken. Thus the bargain which interveners say should have been made could not in fact have been made without destroying the "tax saving" upon which appellants rely for judgment.

Third. The reorganization court would have required the Corporation to sign the returns without a "tax saving" payment. The reorganization court had power to compel the Corporation to sign the returns, had it proved recalcitrant.²⁶ A bankruptcy court has the powers of a court of equity. *S. E. C. v. United States Realty Co.*, 310 U.S. 434, 455, 60 S.Ct. 1044, 1053 (1940). As such, it has full power in a reorganization proceeding to protect the assets of the estate. "The jurisdiction of the bankruptcy court in Chapter X proceedings to protect and preserve the property of the bank-

²⁶The interveners appear to have dropped the argument that the Corporation is entitled to judgment because it could have levied tribute by refusing to sign the returns. They are well advised. A reorganization court pays nothing for nuisance value. "In these proceedings there is no occasion for the court to yield to such pressures." *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 129, 60 S.Ct. 1, 14 (1939). Moreover, if appellants had exacted a price for a signature to the consolidated returns they would have been forced to return the tribute thus collected. It is not common practice to require payment for the service of signing a paper and the cases are not numerous. They agree, however, in requiring repayment of the price exacted. See *Kelley v. Caplice*, 23 Kan. 337 (1880), *aff'd on rehearing*, 27 Kan. 359 (1882); *Guetzkow Bros. Co. v. Breese*, 72 N.W. 45 (Wis. 1897); *Lain v. Rennert*, 32 N.E.2d 375 (Ill. App. 1941); *Oswald v. El Centro*, 211 Cal. 45, 292 Pac. 1073 (1930); *American Bank & Trust Co. v. Federal Reserve Bank*, 256 U.S. 350, 41 S.Ct. 499 (1921); *Rees v. Schmits*, 164 Ill. App. 250 (1911). The contention, moreover, that a hard bargain should have been made with the trustees has no merit in an equity court. "The complaint that its board of directors did not drive a harder bargain, or the hardest bargain, that it might have driven should have no appeal to a court of equity. On the contrary, courts of equity often proceed upon a contrary and opposite theory." *Atwater v. Wheeling & L. E. Ry. Co.*, 56 F.2d 720, 724 (C.C.A. 6, 1932).

rupt estate was not in question and could not be questioned." *Duda v. Sterling Mfg. Co.*, 178 F.2d 428, 434 (C.A. 8, 1949). In the exercise of that jurisdiction the reorganization court would have compelled the Corporation, a party to the reorganization proceeding,²⁷ to join in the returns and thus to conserve the assets of the bankruptcy estate. As sole stockholder of the old company, the Corporation had general fiduciary duties to its subsidiaries, particularly in the interest of the latter's creditors (*Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 522, 61 S.Ct. 675, 683 (1941)) and special duties arising out of the bankruptcy proceeding to conserve the assets for the benefit of creditors.²⁸ Under such circumstances the reorganization court would never have allowed the Corporation to deplete these assets by demanding payment for signing a paper.

(iii) There Has Been No Unfairness to Appellants.

The duality doctrine, even if it has application here, goes no further than to say that the tax transaction should be fairly conducted. By every available standard there has been no unfairness

²⁷*Callaway v. Benton*, 336 U.S. 132, 69 S.Ct. 435 (1949), upon which appellants rely, involved the power of the reorganization court over a stranger to the proceeding.

²⁸Compare 3 *Collier on Bankruptcy* (14th ed.) Par. 62.30, p. 1573: "Among [the duties of the bankrupt] is the duty to preserve the estate for the benefit of the creditors and to do whatever is needed to protect the assets from deterioration until, either a custodian or a receiver or the trustee has taken charge of them. This duty is not specifically mentioned in the statute, but has been recognized by the courts." See also *In re Hines*, 69 F.2d 52 (C.C.A. 2, 1934); *Sellers v. Bell*, 94 Fed. 801, 809 (C.C.A. 5, 1899); *In re Beck*, 92 Fed. 889, 891 (S.D. Iowa 1899); *In re Connecticut Co.*, 95 F.2d 311, 315 (C.C.A. 2, 1938) cert. den. 304 U.S. 571. The obligations of the debtor are binding upon the stockholders of the debtor. Sec. 77(1) provides in part: "In proceedings under this section * * * the duties * * * of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed * * *." And Sec. 7b of the Act provides in part: "Where the bankrupt is a corporation, * * * its stockholders or members, or such of them as may be designated by the court, shall perform the duties imposed upon the bankrupt by this Act." See, e.g., *Goldie v. Cox*, 130 F.2d 695 (C.C.A. 8, 1942); *In re Songood Realty Co.*, 32 F. Supp. 121 (E.D. N.Y. 1940).

to appellants. What was done was in strict accordance with the past practice of the Western Pacific group, with the generally accepted business practice and with the uniform conclusion of the Securities and Exchange Commission, the Treasury Department, the Federal Trade Commission and all persons who have considered the problem. What better test could there be of "fairness"?

Indeed, if "fairness" is the test, it is appellants who must fail. There is no "fairness" in the effort of the Corporation to repudiate for its selfish purposes the established practice of the group; nor in the demand of the Corporation for a payment from a transaction in which it was neither wronged nor damaged; nor in the attempt of the Corporation to substitute itself as tax collector; nor in the effort of the Corporation to deprive the group of the benefit of a tax deduction allowed by Congress; nor in permitting the Corporation to recover a \$17,000,000 judgment against a reorganized company owned by the unpaid creditors of its subsidiary (and their successors in interest) to whom the Corporation owed fiduciary obligations; nor in allowing the Corporation, a party to the reorganization proceeding, to repudiate that proceeding retroactively and assert a claim relating to the reorganization period which was never presented to the reorganization court and which, if allowed, would frustrate the purpose of the reorganization; nor in permitting the Corporation to undermine the financial position of the reorganized company on the basis of an afterthought claim presented too late and in the wrong forum. "Fairness" in this case is with the judgment below.

5. APPELLANTS' AUTHORITIES.

The case on which appellants chiefly rely, *Commercial National Bank in Shreveport v. Connolly*, 176 F.2d 1004 (C.A. 5, 1949) demonstrates the distance by which they fail to support their claim.

The Old Bank, virtually insolvent, conveyed all its assets to the New Bank, which assumed the Old Bank's liabilities to creditors. The contract between the Banks (which proved highly profitable to the New Bank) authorized the New Bank to administer Old Bank assets and collect from them an amount sufficient to indemnify it for the liabilities assumed. The remaining assets were to be reconveyed to the Old Bank or liquidated for the Old Bank's account. The litigation was a suit by the Old Bank for an accounting.

The assets conveyed to the New Bank included certain parcels of real property. The Louisiana statute taxing the capital stock of banks provided that the assessed value of the stock might be reduced by the assessed value of all real property owned by the bank. The New Bank reduced the tax on its capital stock by the value of the Old Bank's real property. The court held, after a prior appeal²⁹ and over dissent, that in the accounting the Old Bank was entitled to a credit for the tax advantage which came to the New Bank from holding that part of the property which was transferred in pledge rather than by an outright conveyance. The basis of decision was the relation between the parties established by the express agreement of liquidation and pledge. The court said:

"We are of the opinion, from a construction of the entire contract and the purpose and intent of the parties, that Class C assets were merely pledged—subject to the right of substitution aforementioned—as indemnity or security to the New Bank against loss in the assumption of the liabilities and in payment of expenses, costs, and charges. In such a situation the law of Louisiana seems to be that a relation of trust exists between the New Bank and the Old in reference to said C assets so pledged, and that the New Bank, as such

²⁹*Commercial National Bank in Shreveport v. Parsons*, 144 F.2d 231 (C.C.A. 5, 1944), rehearing denied, 145 F.2d 191 (1944), cert. den. 323 U.S. 796, 65 S.Ct. 440 (1945). Opinions of the trial court are reported at 28 F. Supp. 927, 44 F. Supp. 5, 64 F. Supp. 888, and 72 F. Supp. 961.

pledgee or trustee, should use the fruits of the pledge only for the benefit of the pledgor or cestui que trust unless the contract or pledge otherwise provides. Hence it follows that such increments, fruits, or profits as derived from Class C real estate savings made in the capital stock taxes of the New Bank should have been credited to the Class C Assets Account." (176 F.2d 1008)

This case has nothing in common with the *Shreveport* case. The reorganization trustees received no assets from the Corporation in pledge or for purposes of liquidation; they had no express liquidating agreement with the Corporation; they held no trust estate with a duty to account to the Corporation for the proceeds of the trust.

A case more closely in point is *Hopkins v. Detrick*, 97 A.C.A. 55, 217 P.2d 78 (1950) in which a husband claimed a portion of tax refunds payable to the wife on the theory, apparently, that by joining in community property returns he "saved" taxes for the wife. The claim was rejected. See also *Cooper v. Central Alloy Steel Corporation*, 43 Ohio App. 455, 183 N.E. 439, 444 (1931), in which a stockholder's complaint about a "tax saving" arising from a merger was rejected because the complainants "were not interested or concerned" since they were "deprived * * * of not one penny."

The cases cited by appellants which deal with consolidated returns are either plainly irrelevant (see *Woolford Realty Co. v. Rose*, 286 U.S. 319, 52 S.Ct. 568 (1932), holding that losses suffered by a subsidiary in years prior to affiliation cannot be deducted in a consolidated return and *Duke Power Co. v. Commissioner*, 44 F.2d 543 (C.C.A. 4, 1930), holding that a return filed by subsidiaries in which the parent did not join was not acceptable), or they support the traditional formula for intragroup settlements without "tax saving" payments. For instance, in *Helvering v. Morgan's, Inc.*, 293 U.S. 121, 55 S.Ct. 60 (1934), the court recognized the propriety of the early statutory formula appor-

tioning the consolidated tax in accordance with net taxable incomes of the group members. No tax saving payment was made or suggested. In *Koppers Co.*, 8 T.C. 886 (1947), 11 T.C. 894 (1948) the intragroup settlement was again according to the established formula and again there was no intimation that tax saving payments were required—and this even though in the *Koppers* situation there was no "economic unity" within the group. See Moody's Industrial Manual 1941, p. 2598. *Bankers Trust Co. v. Florida East Coast Car Ferry Co.*, 92 F.2d 450 (C.C.A. 5, 1937), is no different. Certain subsidiaries there agreed that a cash refund owing to them for overpayment of taxes should be applied to pay the tax deficiency of another group member. The court recognized that this use of the refund otherwise payable in cash created a right in the contributing subsidiaries to a compensatory payment from the subsidiary whose taxes had been thus paid. Here the Corporation made no tax payment to the Government (R. 1306-07) and it was entitled to no refund. All taxes which were paid were paid by the trustees (R. 824, 826, 1306-07). In the unreported decision *In re Missouri Pacific Railroad Co.*, Docket No. 6935 (E.D. Mo. 1947) a subsidiary by joining in the consolidated returns was faced with an actual cash loss on increased taxes. The group paid the subsidiary not the amount by which the loss benefited the group but rather the amount of actual damage to the subsidiary from the returns. The Corporation in this case had no actual damage and on the theory of this decision it has no claim.

Truncale v. Universal Pictures Co., 76 F. Supp. 465 (S.D. N.Y. 1948) merely illustrates the familiar rule that corporate directors are not allowed to profit at the expense of their corporation. The directors reduced their personal taxes by causing the corporation to forego certain tax deductions. This increased the tax of the corporation. The District Court denied a motion for summary judgment on the ground that the corporation might possibly re-

cover the full amount of the profit to the directors since "Directors and other officers of a private corporation cannot either directly or indirectly * * * in any * * * transaction in which they are under a duty to guard the interests of the corporation make any profit for themselves or acquire any other personal benefit or advantage, * * *" (76 F. Supp. at 468). *Edwards v. Lee's Administrator*, 96 S.W.2d 1028 (Ky. Ct. App. 1936), the Kentucky cave case, involves nothing more than a distribution of profits where the defendants "were guilty of repeated trespasses upon" plaintiff's cave property. "The proof likewise clearly indicates that the trespasses were wilful and not innocent." (96 S.W.2d at 1030).

Chelrob, Inc. v. Barrett, 57 N.E.2d 825 (N.Y. 1944) says only this: that the courts, otherwise reluctant to review business transactions, will, when significant dualty appears, make certain that the transactions were fair. The fairness referred to is the fairness which the law requires: a recognition of the rights of the parties. In most cases the extent of those rights requires no discussion. On a sale of property, for example, no one denies that the seller is entitled to a fair price. The problem, as in the *Chelrob* case, is only to determine whether the price was fair.

The decisions cited by appellants in no way support their claims.

6. APPELLANTS HAVE NO SPECIAL CLAIM TO THE 1942 "TAX SAVING."

Appellants apparently believe that the Corporation has a better claim to the 1942 "tax saving" than to the "tax saving" for 1943 and 1944. They rely upon a pre-trial stipulation and order. The settlement of tax liability proposed to the Government provided in form that the returns for 1942, 1943 and 1944 were to be approved as filed and that the claim for refund of 1942 taxes was to be rejected (Ex. P. 7, R. 1658). Interveners applied to the court below for an order restraining the consummation of the settlement on the theory that the rejection of the 1942 refund

claim might be prejudicial to the position of the Corporation in this litigation (R. 346). The parties entered into a stipulation (Ex. P. 7, R. 1658) designed to recognize that the payment of the 1942 tax in the amount of \$4,201,821.54 was in substance a settlement of tax liability not for 1942 alone but for 1942, 1943 and the first four months of 1944. The stipulation also provided that for purposes of the litigation the 1942 refund claim, diminished in proportion to the diminution of the entire tax saving, should be deemed to have been allowed and "paid to the plaintiff as the agent for the affiliated group designated in Regulations 104 and 110, and by the plaintiff paid into court" (R. 1659). The pre-trial order confirmed the stipulation (R. 163).

Appellants argue that the court below concluded that it should leave the parties where it found them and that the Corporation is therefore entitled to the assumed avails of the reduced refund claim. This contention was urged upon the District Court in a motion to amend the findings and rejected.

"Mr. Levy: Your Honor, as I read your opinion, has decided not that we are not entitled to it, not that the defendant is not entitled to it, but rather that the United States government is entitled to it, and as between these two litigants you are going to leave them where you find them.

"The Court: That is not true. I think I also placed the decision on the ground that I couldn't see any reason why the plaintiff would be entitled to it anyhow." (R. 429)

The court, noting that "the plaintiff is only a stakeholder and he doesn't get any greater rights because he is made a stakeholder" (R. 432), made it clear that the effect of the pre-trial order was to protect the position of the Corporation in relation to the reduced refund claim only if it should be found "entitled to it" (R. 428, 429) and denied the motion (R. 453).

The ruling was correct. The 1942 taxes were paid not by the Corporation but by the reorganization trustees (R. 824, 826,

1306-07). The stipulation and pre-trial order gave to the Corporation no better claim to the refund than to the remainder of the "tax savings" of the trustees. When the District Court determined that the Corporation was without a valid claim to any of the "tax savings," the case was disposed of in its entirety.

C. Appellants Have No Claim Based on the Revenue Acts.

The argument that Congress in enacting the revenue acts had some purpose to benefit parent companies in holding company systems is without foundation. There are a number of reasons.

First. The revenue acts create no private rights. They collect revenue to pay the expense of government. *Meriwether v. Garrett*, 102 U.S. 472, 513 (1880). Indeed, if a tax law requires the payment of money from one private person to another, it becomes unconstitutional. *United States v. Butler*, 297 U.S. 1, 61, 56 S.Ct. 312, 317 (1936). Appellants argue for a construction of the revenue acts which would make them invalid.

Second. There is nothing either in the material quoted by appellants or elsewhere in the extensive history of consolidated returns³⁰ to indicate that Congress intended to confer a special benefit on holding companies. The true purposes of consolidated returns are well understood. They are, first, to facilitate the administration of the tax laws by relieving the Treasury of the burden of reallocating income and deductions on transactions between affiliated companies³¹ and, second, to do tax justice be-

³⁰A tabulation of this material appears in Appendix B, p. 23.

³¹The House Ways and Means Committee reported as follows on the Revenue Act of 1934:

"Your committee considered at length the question of abolishing the consolidated return. Our subcommittee originally recommended this action. The Treasury believed this policy undesirable. The Treasury pointed out that the one way to secure a correct statement of income from affiliated corporations is to require a consolidated return, with all intercompany transactions eliminated. Otherwise, profits and

tween businesses organized as subsidiaries on one hand and businesses organized by departments on the other.³² In a business organized by departments the losses of one department offset the income of another. If the same business were organized by subsidiaries this offsetting, without consolidated returns, would not take place. Consolidated returns collect an equal tax from both enterprises. There is nothing here to suggest that Congress has any particular regard for holding companies.

Third. The Corporation cannot recover in this Court by speculating on an intent of Congress as deduced from casual language in committee reports relating to revenue acts. Congressional intent becomes significant in court only when Congress has passed a statute. If Congress had intended that holding companies as such should have the benefit of consolidated returns Congress would have enacted a bill which said so—providing, of course, that somewhere in the Constitution power could be found to support such legislation.

losses may be shifted from one wholly owned subsidiary to another, and their separate statements of income do not present an accurate picture of the earnings of the group as a whole. * * * The administration of the income tax law is simpler with the consolidated return since it conforms to ordinary business practice; enables the Treasury to deal with a single taxpayer instead of many subsidiaries; and eliminates the necessity of examining the bona fides of thousands of inter-company transactions." H. Rep. No. 704, 73d Cong., 2 Sess, p. 16.

See, also, S. Rep. No. 960, 70th Cong., 1st Sess, pp. 1, 13, 29; Hearings of House Ways and Means Committee on Revenue Revision, 1934, pp. 86, 99; Report of the Joint Committee on Internal Revenue Taxation on the Revenue Act of 1926, p. 63.

³²See Memorandum the Finance Committee of the Senate on the 1918 Act:

"Where a corporation does business through subsidiary corporations, such subsidiaries represent in effect merely different departments of one business. It is just as illogical to tax these subsidiaries separately as it would be to levy a separate tax upon the profits earned by different departments of a single corporation." (p. 9)

See, also, Report of Senate Finance Committee on the Revenue Bill of 1928 as quoted in the Hearings before the Senate Finance Committee on the Revenue Act of 1932, p. 24; Senate Report No. 665, 72d Cong., 1st Sess., p. 9.

Fourth. Appellants' argument is founded upon a singularly unsophisticated view of holding company systems. Appellants would have the Court believe that the holding company systems which file consolidated returns are single ownerships. Nothing could be further from the truth. Consolidated returns can be filed if and whenever 95 percent of the voting stock is within the system (I.R.C. Sec. 141(d)). This says nothing about non-voting common, preferred stocks and senior securities such as notes and bonds. Those securities are normally in the hands of the public. No one knows this better than Congress and it is hardly likely that Congress which has in general been hostile to holding companies would intend by consolidated returns to confer an advantage on those holding companies at the expense of their subsidiaries, the operating companies owned in truth by the public.

Fifth. Appellants' argument that the consolidated return system is intended to benefit holding companies is directly in contradiction to the conclusion of a more studious and unbiased witness. The Federal Trade Commission for several years conducted an elaborate investigation of utility holding company systems, out of which came the Public Utility Holding Company Act of 1935. One aspect of utility operation which the Commission reviewed in detail was the use of consolidated returns. The Commission concluded that the purpose of those returns was to benefit not the holding companies but their subsidiaries. The Commission said:³³

"The subsidiary companies in a holding company group are entitled to the benefit of any savings to the group due to filing a consolidated income tax return."

³³Summary Report of the Federal Trade Commission to the Senate of the United States pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A Sen. Doc. No. 92, 70th Cong., 1st Sess., p. 478. This report is quoted at greater length in Appendix B, p. 2.

Appellees commend to the Court this conclusion of the Federal Trade Commission.

Sixth. Congress, in so far as it has indicated an intention as to who should receive the benefit of "tax savings" from consolidated returns, has indicated that those savings should go to the operating companies of the group. In considering the bill which eventually became the Public Utility Holding Company Act of 1935, the Congressional committee was sharply critical of the practice which appellants now advocate, that is, a practice whereby the parent company takes to itself the benefit of group "tax savings." For example, Senator Wheeler, chairman of the Senate Committee on Interstate Commerce, in speaking of this practice said of the holding companies: "So that, as a matter of fact, they took that \$9,000,000, which should have gone either to the Government, or, if it was not necessary to pay it to the Government, *then it should have gone back to the operating company.*"³⁴ (Emphasis supplied.) References to similar comments on appellants' position are noted in the margin.³⁵ Thus to the extent that Congress has indicated a preference as to who should receive the benefits of "tax savings" from consolidated returns it has taken a position precisely contrary to that for which appellants argue.

One final point should be made as to the law arguments which appellants advance. Those arguments are founded on doctrines of unjust enrichment and duality which have been in the law for many years. Never, however, have these arguments, or an assumed purpose of Congress in connection with consolidated returns, led to the conclusion which appellants argue. On the contrary, every tribunal, every informed person who has considered the problem, has reached the opposite conclusion.

³⁴Hearings before the Senate Committee on Interstate Commerce, 74th Cong., 1st Sess., on S. 1725, p. 255.

³⁵Hearings before the Committee on Interstate and Foreign Commerce, House of Representatives, 74th Cong., 1st Sess. on H.R. 5423, pp. 153, 849, 992, 1061, 1522; Hearings before the Committee on Interstate Commerce, United States Senate, 74th Cong., 1st Sess. on S. 1725, pp. 83, 122, 255, 557.

II. THE DECISION BELOW IS IN ACCORDANCE WITH ALL THE PRECEDENTS, WITH GENERAL BUSINESS PRACTICE AND WITH THE SPECIAL EQUITIES OF THIS CASE.

The decision of the District Court refusing to recognize appellants' claim for a "tax saving" payment is supported by all the precedents, by general business practice and by the special equities of this case.

A. The Decision Below Is in Accordance with General Business Practice.

Since 1918 it has been regular practice for the business community to file consolidated tax returns. From 1928 to 1944, for example, 54,685 such returns, involving more than 176,000 companies, were placed on file.³⁶ In each of these 50,000 cases the problem of adjusting intra-group rights and liabilities was necessarily presented. The formula which has always been used is the formula which the Western Pacific group has always followed and which appellants seek to repudiate: an allocation of the tax as calculated in the consolidated return to the group members in proportion to their respective taxable incomes and with no "tax saving" payment.

The Securities and Exchange Commission has noted the existence of the settled business practice:

"We note the customary solution of a somewhat similar problem that arises when a group of companies files a consolidated tax return. In assigning to each constituent its fair share of the consolidated tax paid by the group it is usual to divide the actual tax among the companies who would have had to pay a tax on an individual basis. If one of the included companies operated at a loss, the consoli-

³⁶See for 1928-1941, Statistics of Income for 1941, Part 2, p. 293; for 1942, Treasury Press Release No. 44-54, December 31, 1944, p. 16, and No. V-229, February 25, 1946, p. 6; for 1943, Treasury Press Release No. V-229, February 25, 1946, pp. 6 and 10; for 1944, Statistics of Income for 1944, Part 2, Preliminary, pp. 10-11.

dated tax is of course reduced, but *no* part of the 'saving' is ordinarily paid over to the loss company by the other members of the group."

(Release No. 53, Accounting Series, November 16, 1945, 3 C.C.H. Fed. Sec. Law Serv. 2d ed., Par. 72, 071)

Appellees offered at the trial to support this statement by detailed proof of the business practice as revealed by a special survey of the railroads, the utility systems and representative industrial companies. The proof, excluded as irrelevant (R. 1383), would have demonstrated that business systematically does what appellees say should be done and what was done in this case (R. 1387-93).

B. The Decision Below Is in Accordance with All the Precedents.

The precedents on the proper settlement of intragroup liabilities in connection with consolidated returns come from those tribunals and departments of government which are most intimately concerned with holding company systems: the Securities and Exchange Commission, the Treasury Department, the Federal Trade Commission and the Interstate Commerce Commission. Without exception the practice which has been recommended is the practice which was followed in this case. There is no contrary view.

First. The Securities and Exchange Commission has ruled that the proper practice is to allocate pro rata the consolidated tax without "tax saving" payments. Rule U-45(b) (6), adopted for the regulation of public utility systems, forbids intragroup extensions of credit without S.E.C. approval except in certain cases, one of which is:

"(6) A loan or extension of credit or an agreement of indemnity arising out of a consolidated tax return filed by a holding company (or other parent company) and its subsidiaries: *Provided*, That the top company in the group as-

sumes primary responsibility for the payment of any tax liability involved, subject to the right to contribution from the several members of the group in an amount *not exceeding* as to any company that percentage of the sum of the normal tax, surtax and excess profits tax on a consolidated basis which the sum of the normal tax, surtax and an excess profits tax of such company if paid on a separate return basis is of the aggregate amount of normal, surtax and excess profits taxes of the individual companies based upon separate returns. * * *³⁷ (Emphasis supplied.)

Appellants cite and rely upon three instances in which the Commission is said to have permitted deviations from this formula. In Release No. 4444, dated July 28, 1943, "In the Matter of Consolidated Electric Gas Company, The Islands Gas & Electric Company," Islands, a subsidiary in the Consolidated group, had large war losses in Manila, which were available as tax deductions for the group. If, however, Islands reacquired its properties it would be required to pay the tax which the deductions had eliminated (I.R.C. Sec. 127(c)). The group members proposed a special arrangement to protect Islands against this tax if it were later assessed. The Commission agreed. The purpose of the arrangement was to make certain that Islands did not pay more tax by joining in the consolidated return than it would have paid on a separate return basis. This principle is of no value to appellants. The Corporation paid no tax under the consolidated returns (R. 824, 826, 1306-07).

This same purpose to protect a subsidiary from an actual loss through paying extra taxes on account of a consolidated return underlies the ruling of the Commission in Release No. 5535, dated January 3, 1945, "In the Matter of Cities Service Company." There a subsidiary was amortizing the cost of a plant at a

³⁷For a detailed discussion as to the effect of the Rule by the semi-official National Association of Railroad and Utility Commissioners see Appendix B, p. 14.

special war-time rate which would result in complete amortization in five years. This provided the subsidiary with large deductions from taxable income which were useful to the group in consolidated returns. It also meant that after the five year period the subsidiary would have no amortization deduction. The group members accordingly agreed to compensate the subsidiary for the disadvantage to it arising from the tax procedures adopted.

The basis for decision in Release No. 4806, dated January 3, 1944 "In the Matter of Consolidated Electric & Gas Company" is stated by the Commission as follows:

"Inasmuch as Consolidated owns 100% of the common stock equity of each of its subsidiaries affected by the proposal, and there do not appear to be impairments in the earned surplus accounts of such subsidiaries, it is, apart from the accounting consequences of the transaction, immaterial whether the proposed payments are made in the manner proposed or the books of the subsidiaries are permitted to reflect the taxes as reduced by the subject savings and corresponding amounts paid to Consolidated by way of dividends."

Since the parent who received the payment was entitled to the money in any event, the Commission saw this case only as an accounting problem and agreed to the proposed arrangement for that reason.³⁸

These releases, it will be noted, are not in any way concerned with the *rights* of group members. The Commission did not intimate that the group member receiving the proposed payment had a right to compel it. Appellants, per contra, seek a ruling compelling payment. No such question was before the Commission in the cited cases. Indeed, if the law required "tax saving" payments, Rule U-45(b)(6), which in effect forbids such payments, would be invalid.

³⁸Subsequent to the releases upon which appellants rely the Commission gave further attention to "tax savings," criticizing appellants' position from the point of view of sound accounting. See Appendix B, p. 7.

Second. The rulings of the Treasury Department assume and provide for a pro rata allocation of the consolidated tax without tax saving payments. The allocation formula adopted by the Western Pacific group appeared in the Revenue Acts of 1921, 1924 and 1926.³⁹ In 1928 Congress made all members of an affiliated group (except for a few special occasions) responsible for the full amount of the tax⁴⁰ and no allocation formula has since appeared in the statute. For special occasions, however, such as allocating consolidated excess profits tax to provide deductions from normal tax net income, the Treasury has designated the customary formula⁴¹ and the Bureau of Internal Revenue has ruled that it is to be used to determine earnings and profits available for dividends.⁴²

³⁹Section 240(b) of the Revenue Act of 1921 provided:

"(b) In any case in which a tax is assessed upon the basis of a consolidated return, the total tax shall be computed in the first instance as a unit and shall then be assessed upon the respective affiliated corporations in such proportions as may be agreed upon among them, or, in the absence of any such agreement, then on the basis of the net income properly assignable to each."

An identical provision appeared in the Revenue Acts of 1924 and 1926.

⁴⁰See Art. 15(a) in Treas. Regs. 75 (1928), 78 (1932), 89 (1934), 97 (1936), 102 (1938), and Treas. Reg. 104, Sec. 23.15(a) (1942).

⁴¹See T.D. 5086, Amendments to Regulations 103 [1941-2 Cum. Bull. 46-7]. The text is in Appendix B, p. 23.

⁴²I.T. 3637, 1944 Cum. Bull. 258, and I.T. 3692, 1944 Cum. Bull. 261. The texts are in Appendix B, pp. 17 and 21. The consolidated return regulations (Treas. Regs. 104 and 110) assume that the tax allocation will be in accordance with the accepted formula. There are no specific provisions since before now it has never been suggested that consolidated returns required any "tax saving" payment. The regulations contain, however, provisions which are plainly inconsistent with appellants' proposal. They require, for example (Treas. Reg. 104, Sec. 23.34(c)), that whenever income of a parent company is offset in a consolidated return by the loss of a subsidiary (which could not have been availed of by the subsidiary in a separate return), the tax basis upon which the parent holds the stock of the subsidiary must be reduced in an amount equal to the loss. Then upon liquidation or sale of the stock of the subsidiary the amount of gain on which the parent must pay tax is increased. This rule was first developed in the decisions. See *Jordahl & Co.*, 35 B.T.A. 1136, 1139 (1937). Plainly neither the courts in adopting this rule nor the Commissioner in formalizing

Third. The Federal Trade Commission has approved the formula which appellees defend and condemned the formula which appellants propose. The Corporation, as parent, proposes that it should receive from the group members a "tax saving" payment equal to the tax which each group member would have paid had it filed a separate return. This practice, as adopted in the 1920's by a few of the more notorious utility systems, was one reason why the Securities and Exchange Commission was created. The Federal Trade Commission conducted an extensive investigation of the utilities prior to the enactment of the Public Utility Holding Company Act and condemned the practice which appellants ask this Court to establish as law:

"Holding companies are not justified in recording as income the savings from this procedure of handling Federal income-tax payments. *The subsidiary companies in a holding-company group are entitled to the benefit of any savings to the group due to filing a consolidated income-tax return.* Only the amount of Federal income tax paid by a holding company on the basis of a consolidated return should be borne, in proportion to the taxable income, by those companies having taxable income, for which companies a consolidated return was filed. Stated differently, each company in a holding-company group should pay only its pro-rata share of the tax paid for the group." (Emphasis supplied.)⁴³

Appellants are asking the Court to adopt a practice which Congress intended that the Securities and Exchange Commission should eliminate in the utility field and which has been eliminated.

it in the regulations intended that the one group member should pay another for the tax benefit of its loss. This would require a double payment for the tax benefit: once to the loss company and once to the Government in increased taxes through reduction in the tax basis of the stock.

⁴³Summary Report of the Federal Trade Commission to the Senate of the United States pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A Sen. Doc. No. 92, 70th Cong., 1st Sess., p. 478. This report is quoted at greater length in Appendix B at p. 2.

Fourth. The Interstate Commerce Commission has refused to recognize "tax saving" claims. There is no formal ruling by the Interstate Commerce Commission on the proper allocation of taxes under consolidated returns, perhaps because, as appellees offered to prove (R. 1387-93), the railroads universally employ the traditional formula. The Commission has had occasion, however, to consider and reject "tax saving" claims. One case involved the segregation of earnings between a reorganization debtor and its leased lines;⁴⁴ another involved the computation of benefits awarded to bondholders on an issue of new securities.⁴⁵

These are the rulings now available on the specific question before the Court. They reach a single and unanimous conclusion: that consolidated returns do not create claims for "tax saving" payments.

C. The Decision Below Is in Accordance with the Special Equities of This Case.

Appellants seek to escape the accumulated force of the past practice of the Western Pacific group, the general business practice and all the precedents by arguing that there are special circumstances in this case which require a departure from established procedures. The argument is unsound. The special circumstances of the case provide no reason for abandoning the past practice—on the contrary, they provide special and additional reasons for following that practice.

1. THE CIRCUMSTANCES OF THE CASE REQUIRE THAT THERE SHOULD BE NO "TAX SAVING" PAYMENT TO THE CORPORATION.

The situation of the Western Pacific during 1942 and thereafter provided a number of special reasons for following the

⁴⁴*Central of Georgia Railway Co. Reorganization*, 252 I.C.C. 587, 600 (1942).

⁴⁵*St. Louis-San Francisco Railway Co. Reorganization*, 257 I.C.C. 399, 410 (1944).

accepted formula in allocating group liabilities in connection with consolidated returns.

First. The group at the direction of the Corporation had followed the established formula for twenty years (R. 1262, Ex. D. 40). Over the years that formula had produced a total tax saving to the Corporation of \$593,976.33 (Ex. D. 46, R. 2040) for which the Corporation had made no tax saving payments to the group members (R. 1262, Ex. D. 40). With the termination of affiliations in sight and an opportunity now available whereby the other group members could benefit from the accepted formula, it would have been grossly unfair to have abandoned that formula simply because some other procedure now became more advantageous to the Corporation.

Second. The creditors of the old company were unpaid and the company was in reorganization. Those creditors holding first mortgage and income bonds (*In re Western Pac. R. Co.*, 34 F. Supp. 493, 497) were, on any analysis, entitled to a preferred position over the Corporation which held only unsecured claims and the stock interest (34 F. Supp. 493, 497). A settlement of the intragroup liabilities in accordance with the past practice gave the benefit of the "tax savings" to those unpaid creditors. A "tax saving" payment, per contra, would have preferred the stock and unsecured interest over the bondholders with their secured position. It would have been a flagrant violation of the duties of a holding company to the creditors of its system.

Third. The "tax saving" was a saving to the reorganization trustees. Those trustees held the railroad properties and the income produced from them for the benefit of the creditors of the bankruptcy estate according to normal ranking—the secured creditors first and the stock interest last. The application of the established formula with no "tax saving" payment to the Corporation left undisturbed the normal ranking; a "tax saving" payment would have reversed that ranking.

Fourth. The Corporation had only a remote possibility, even if affiliation had continued, of receiving any benefit from the "tax saving." Creditors had a prior position which had to be recognized. A "tax saving" payment to the Corporation would have converted that remote possibility into actual cash in hand, a procedure radically unfair to those with a senior position.

Thus it is clear that the special circumstances of the case provided no reasons for a departure from the established practice but, instead, special reasons for following it.

2. THE ALLEGED SEVERANCE OF "ECONOMIC UNITY" AFFORDS NO REASON FOR A SPECIAL CONCLUSION.

Appellants argue that the Supreme Court decision of March 15, 1943 (318 U.S. 448) approving the reorganization plan "severed the economic unity" of the group and thereby created circumstances requiring a special conclusion. This argument has no substance.

First. The Supreme Court decision "severed" nothing. On that date the court approved the Interstate Commerce Commission's plan of reorganization which held worthless the Corporation's interest in the old company. It then became probable (but not certain, see *Insurance Group v. D. & R. G. W. R. Co.*, 329 U.S. 607, 617 n. 6, 67 S.Ct. 583, 587 (1947)) that the reorganization plan would thereafter be confirmed by the District Court, that mechanics would be provided for putting it into operation and that at some undetermined date in the future the old stock would be cancelled and affiliation would cease to exist. Nothing else then occurred. The stock of the old company remained in the hands of the Corporation. The affiliation continued. Appellants are arguing that the formula used by the Western Pacific group for settling intragroup liabilities for twenty years should have been changed because termination of affiliation was in sight. Why?

Second. The "economic unity" in the Western Pacific group

which, according to appellants, was severed on March 15, 1943, had never existed. From the outset the majority of the first mortgage bonds of the old company were with the public (34 F. Supp. 493, 497). As the financial condition of the old company became more critical, the value of the stock interest disappeared and the company belonged in truth and in equity to its bondholders. *United States v. Butterworth-Judson Corp.*, 269 U.S. 504, 513, 46 S.Ct. 179, 180 (1926); *In re Central Funding Corporation*, 75 F.2d 256, 259 (C.C.A. 2, 1935). There was no "economic unity." It could not, therefore, have been severed on March 15, 1943.

Third. "Economic unity" in matters related to consolidated returns is a false factor demonstrably of no significance. Rarely, if ever, does "economic unity" exist in holding company systems. Only in the exceptional case does the parent company completely own the subsidiaries. More often the parent, by ownership of the voting stock, controls properties which in reality belong to the public through the purchase of senior securities.⁴⁶ The revenue acts recognize this diverse economic interest in the ordinary holding company system and they make no requirement of economic unity as a condition for filing consolidated returns. They require only that ninety-five per cent of the voting stock be held within

⁴⁶Summary Report of the Federal Trade Commission on Economic Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess. See for example p. 311:

"On the other hand, the long term debt of the operating companies consists mostly of bonds which are secured by mortgage on their physical properties. The long term debt together with preferred stock usually represent the capital obtained from the investing public. The common stock of the operating companies is usually the voting stock and is owned by the holding companies for control purposes."

See, also, Barnes, *The Economics of Public Utilities Regulation* (1947) p. 73; Bonbright and Means, *The Holding Company* (1932) p. 147; 2 Dewing, *The Financial Policy of Corporations* (4th ed. 1941) p. 1042. Dewing reports that in seven large holding companies, a total of 52% of the bonds, 32% of the preferred stock and 16% of the common stock was publicly held (p. 1051).

the group (I.R.C. Sec. 141).⁴⁷ Thus in emphasizing economic unity appellants would have the Court accept the rare situation as the ordinary situation and give significance to a factor to which Congress has attached no significance.

Fourth. The accepted formula for the settlement of intra-group liabilities in connection with consolidated returns makes nothing turn on economic unity. The Securities and Exchange Commission, the Treasury Department, the Federal Trade Commission and the Interstate Commerce Commission are all intimately concerned with holding company groups. The officials of those tribunals are thoroughly familiar with the fact that ordinarily there is no economic unity within the group. They have nevertheless ruled that the intragroup settlement should be made without "tax saving" payments. No exceptions are stated in terms of "economic unity."

Fifth. The assumption by appellants that a holding company in ordinary course receives the benefit of all "tax savings" to its subsidiaries is contrary to fact. Appellants suggest that every benefit to a subsidiary is a benefit to the parent. The Supreme Court has reached a contrary conclusion. "So various are the pos-

⁴⁷Since 1918 the Revenue Acts have progressed steadily away from any theory of economic unity or common ownership as far as consolidated returns are concerned. The 1918 statute defined affiliation in general terms of ownership or control (Section 240b). By progressive steps through the Revenue Act of 1924 and the Revenue Act of 1928 the theoretical approach has been abandoned in favor of a technical requirement—ownership of 95% of the voting stock. See 8 Mertens, *Law of Federal Income Taxation* (1942) Sec. 46.13, p. 426.

The cases talk from time to time of a single business enterprise, but whenever it is important they have recognized that the test is what the statute requires and nothing more. See *United States v. Donaldson Realty Co.*, 106 F.2d 509, 517 (C.C.A. 8, 1939); *Commissioner v. General Gas & Electric Corp.*, 72 F.2d 364, 365 (C.C.A. 2, 1934); *Erie Lighting Co. v. Commissioner*, 93 F.2d 883 (C.C.A. 1, 1937). The basic theory of consolidated returns is of course that the returns serve only as a method of computing the tax owing by the individual group members who are and remain the taxpayers. See *Helvering v. Morgan's, Inc.*, 293 U.S. 121, 127, 55 S.Ct. 60, 63 (1934).

sible permutations and combinations of the economic factors that equivalence of surplus or deficit in the accounts of the subsidiary with the gain or loss to the parent would be mere coincidence." *Commissioner v. Phipps*, 336 U.S. 410, 421n, 69 S.Ct. 616, 622 (1949). The Treasury Department agrees: "Moreover, there is no reason for the assumption that the entire earnings of a subsidiary would become dividends to the parent" (Treasury Department release of June 9, 1948, "Consolidated Returns and Inter-corporate Dividends," p. 12). If, to take some obvious examples, bonds are in default, debenture interest unpaid, preferred stock in arrears or general creditors unsatisfied, the benefit of any tax reduction on account of consolidated returns never reaches the parent.

In the final analysis the Corporation's position in this case has two elements: that of a holding company and that of a group member whose loss was claimed as a deduction in a consolidated return. The Corporation *as parent* has no right to take to itself the "tax savings" realized by its subsidiaries through the consolidated returns. That abuse of the holding company position has been condemned by Congress (this brief p. 51) and the Federal Trade Commission (this brief p. 50) and eliminated in the utility field by the Securities and Exchange Commission (this brief p. 53). As parent, the Corporation can claim nothing. As a loss company receiving no benefit from the loss, the position of the Corporation is not improved. The entry of a loss in a consolidated return produces no right to compensation in the loss company. This can be demonstrated by the general business practice, the past practice of the Western Pacific group and all the relevant rulings. Subsidiaries normally hold no stock in the parent company or in other group members. They therefore receive no benefit from "tax savings" to the group through their losses. Nevertheless, the subsidiaries never receive "tax saving" payments. If the entry of a loss in a consolidated return entitles

the loss company to compensation because it otherwise has no benefit, virtually every intra group settlement in the past thirty years has been improper and public investors in subsidiary companies have been unlawfully deprived for thirty years of an asset to which they were entitled.

D. The Decision Below Is in Accordance with Sound Policy.

The decision of the District Court refusing to recognize the "tax saving" claim of the Corporation is supported by sound policy. The reasons include:

First. The fact that the Revenue Acts do not create private rights. A tax is an impost levied by the government to obtain revenues to maintain its existence. *Meriwether v. Garrett*, 102 U.S. 472, 513-14 (1880). It creates no private rights. *United States v. Butler*, 297 U.S. 1, 61, 56 S.Ct. 312, 317 (1936).

Second. The fact that "tax saving" payments, if allowed, would contravene the policy against merchandising tax advantages. Transactions which have only a tax purpose are not recognized by the tax law. *Gregory v. Helvering*, 293 U.S. 465, 55 S.Ct. 266 (1935); I. R. C. Sec. 129. "Tax saving" payments, if approved, would provide a new motive for distorting business transactions with relation to the tax law.

Third. The fact that "tax saving" payments, if required, would create great uncertainties in commercial law. Husbands and wives file joint returns (I.R.C. Sec. 51(b)); stockholders to save taxes sell the stock of a business rather than its assets; a lawyer sends a December bill to make a deduction available to his client in the current tax year. Do these ordinary transactions create claims for taxes "saved"?

Fourth. The fact that a requirement of "tax saving" payments would unnecessarily complicate the tax system. Taxation "can never be made simple but we can try to avoid making it needlessly complex." *Dobson v. Commissioner*, 320 U.S. 489,

495, 64 S.Ct. 239, 243 (1943). To impose upon an already complex tax system a complementary system of "tax saving" payments would unnecessarily multiply the complexities of tax administration.

The settled practice against "tax saving" payments should not be disturbed.

III. APPELLANTS' CLAIM IS INEQUITABLE

In this equity proceeding no relief can be granted if the claim presented is without equity. There is no equity in appellants' position.

A. The Corporation Cannot in Equity Repudiate Retroactively the Tax Allocation Formula Followed by the Group for Twenty Years.

Since 1918 the Western Pacific group has filed consolidated tax returns (Ex. D. 40). At the direction of the Corporation the tax under the consolidated return has been allocated to the group members in proportion to net income (R. 1262). There has never been a "tax saving" payment (Ex. D. 40, R. 1262). On many occasions this practice resulted in tax reductions for the Corporation. In each year from 1924 to 1935 the Corporation received a "tax saving" because the loss of another group member was included in consolidated returns (Exs. D. 40, D. 46, R. 2040). The tax thus "saved" totalled \$593,976.33 (Ex. D. 46, R. 2040). No payment was made for that saving (R. 1262, Ex. D. 40).

The established formula was followed for each of the years in question. Only long after the event, after the returns were on file, after the reorganization trustees were discharged, after the reorganization proceeding was closed, after it was no longer possible for the trustees to file separate returns and take advantage of deductions unavailable under consolidated returns was this claim asserted. It is, as the court below pointed out, "an after-

thought" (R. 274), a tribute to a lawyer's ingenuity. It has no substance. But if appellants should be successful they will impose upon appellees a total burden of taxes and "tax saving" payments far in excess of the original tax obligation to the Government. This effort to repudiate retroactively the formula which the group had accepted for twenty years cannot commend itself to a court of equity.⁴⁸

B. The Corporation Cannot in Equity Deplete the Assets of Its Former Subsidiary at the Expense of Creditors Who Were Not Paid in Full.

This is a demand for \$17,201,739.00 presented against a reorganized railroad by the former parent company. That company directed its former subsidiary to sell securities to the public. The purchasers of those securities are the stockholders (and their successors in interest) of the reorganized company. To these stockholders, as creditors of the old subsidiary, the appellant Corporation owes fiduciary obligations. *Consolidated Rock Products Co. v. Du Bois*, 312 U.S. 510, 522, 61 S.Ct. 675, 683 (1941).

By the plan of reorganization the old bondholders became the present stockholders. The exchange of securities was made on the assumption that the preferred stock of the reorganized company would be worth \$100 per share and the common stock \$57 per share. *Western Pac. R. Co. Reorganization*, 233 I.C.C. 409, 417 (1939). Even on this basis the secured creditors of the old company were not paid in full. The securities issued to the A. C. James Company, the creditor holding the junior secured position, fell short of paying that company's claim by \$3,495,900 (Ex. D.

⁴⁸Compare the many estoppel cases in which it has been held that one who participates in an established course of conduct over a long period may not, after the event, attach new consequences to customary activity. See, for example, *Stagg v. Insurance Company*, 10 Wall. 589 (U.S. 1871; *Railroad Company v. United States*, 103 U.S. 703 (1881); *County of Los Angeles c. Cline*, 185 Cal. 299, 197 Pac. 67 (1921).

33, R. 2021). With interest, that unpaid claim now amounts to more than \$5,000,000.00.

This \$5,000,000.00 does not measure, however, the amount by which the secured creditors were not paid. The securities of the reorganized company have never had the market value assumed by the plan. This Court is entitled to take judicial notice of the fact that during 1949 the preferred ranged in value between \$68.50 and \$54.50 per share and the common between \$22 and \$30. *Insurance Group v. D. & R. G. W. R. Co.*, 329 U.S. 607, 617, n. 6, 67 S.Ct. 583, 587 (1947). Thus far in 1950 the range of the preferred has been between \$64.50 and \$83.50 and of the common between \$28.00 and \$45.00. The former creditors of the old company, now stockholders of the reorganized company, not only surrendered their first mortgage bonds for securities of an inferior grade (income bonds, preferred stock and common stock) but those inferior securities have never achieved the value which the plan assumed they would have. Appellants now propose to further reduce the assets of these creditors, now stockholders, by \$17,201,739.00. Nothing could be more inequitable. Nothing could be more inconsistent with the fiduciary obligation owing from the Corporation to those creditors. Nothing could more plainly violate the settled principle that creditors have an absolute priority over stockholders. *Northern Pacific Ry. v. Boyd*, 228 U.S. 482, 504, 33 S.Ct. 554, 560 (1913); *Case v. Los Angeles Lumber Co.*, 308 U.S. 106, 129, 60 S.Ct. 1, 14 (1939). Nothing could be more radically at odds with the Supreme Court doctrine that the claim of a holding company in the reorganization of its subsidiary must, whatever its technical status, yield to the necessity of doing justice to the creditors of that subsidiary. *Taylor v. Standard Gas Co.*, 306 U.S. 307, 59 S.Ct. 543 (1939).

IV. APPELLANTS' CLAIM IS BARRED BY THE FAILURE TO PRESENT IT DURING THE REORGANIZATION PROCEEDING AND BY THE FINAL ORDERS OF THE REORGANIZATION COURT.

Even if it were assumed that appellants once had a valid claim to a "tax saving" payment, the failure to have it approved by the reorganization court bars recovery.

During 1942, 1943 and the first four months of 1944 the reorganization trustees earned large amounts of income from the railroad properties. That income was subject to tax. The tax liability, if any, was a liability of the trustees, *Reinecke v. Gardner*, 277 U.S. 239, 241, 48 S.Ct. 472, 473 (1928); 415 *South Taylor Building Corp.*, 2 T.C. 184, 192 (1943); and the tax, if paid, would have been a cost or expense of administration. *Gardner v. New Jersey*, 329 U.S. 565, 575, 67 S.Ct. 467, 472 (1947); *Goggin v. Bryan*, 172 F.2d 868 (C.A. 9, 1949); *McColgan v. Maier Brewing Co.*, 134 F.2d 385, 387 (C.C.A. 9, 1943). Appellants' claim, based upon an alleged saving of trustee taxes, would, if paid, also have been an expense of administration, that is, an expense of operating the properties during the reorganization period. The question becomes: May appellants, who failed to file claim for payment of an expense of administration in the reorganization proceeding, thereafter, and after the reorganization proceeding is closed, demand payment from the reorganized company? The answer is plainly no.

A. Appellants' Claim Is Contrary to the Policy of Section 77 of the Bankruptcy Act and to the Purpose of the Western Pacific Reorganization.

A defense based upon the bar of a reorganization proceeding is meritorious. It responds to the fundamental purpose of Section 77 of the Bankruptcy Act to rehabilitate the debtor in order that it may discharge its public service functions.

"Stated briefly, Sec. 77 has for its main purpose 'the rehabilitation of the debtor by a readjustment of its finan-

cial structure in the interest of the debtor and its creditors and security holders, under a fair and equitable plan of reorganization which shall so modify or alter the rights of both secured and unsecured creditors that the fixed charges shall be brought within the probable future earnings available for the payment thereof.' * * * To this end, any reorganization plan should not merely provide immediate relief, but should be drastic enough to assure the continued solvency of the enterprise, even under unfavorable conditions. * * *" 5. *Collier on Bankruptcy* (14th Ed.) Sec. 77.02, pp. 468, 469. (Footnotes and references omitted.)

This public purpose of railroad reorganizations has been emphasized by the Supreme Court. "A basic requirement of any reorganization is the determination of a capitalization which makes it possible not only to respect the priorities of the various classes of claimants but also to give the new company a reasonable prospect for survival." *Group of Inst. Investors v. Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 540, 63 S.Ct. 727, 738 (1943); *Ecker v. Western Pac. R. Corp.*, 318 U.S. 448, 474, 63 S.Ct. 692, 708 (1943). If a reorganization proceeding is to be effective in rehabilitating the debtor two things are required:

First. The reorganization court must consider and pass upon all possible claims which might be asserted against the reorganized company. "The very kernel of a reorganization proceeding is the careful consideration given to all outstanding liabilities, debts, and claims. Only in the light of such an examination does it become possible for the bankruptcy court to determine whether the corporation as recapitalized can weather the financial storm." *American Service Co. v. Henderson*, 120 F.2d 525, 529 (C.C.A. 8, 1941); *Guaranty Trust Company of New York v. Henwood*, 6 F.2d 347, 354 (C.C.A. 8, 1936) cert. den. 300 U.S. 661. To accomplish this objective of full consideration of all possible liabilities Congress has provided that claims which are not provable in an ordinary bankruptcy can be presented in a reorganiza-

tion *Foust v. Munson SS Lines*, 299 U.S. 77, 82, 57 S.Ct. 90, 93 (1936); *American Service Co. v. Henderson*, 120 F.2d 525 (C.C.A. 4, 1941), and this, even though they are "executory or contingent presently due or to mature in the future."⁴⁹ *City Bank Co. v. Irving Trust Co.*, 299 U.S. 433, 57 S.Ct. 292 (1937); *Hippodrome Building Co. v. Irving Trust Co.*, 91 F.2d 753, 755 (C.C.A. 2, 1937).

Second. The reorganization must put an end to all outstanding claims. This applies to all reorganizations: to Chapter X proceedings

"The theory is that there comes a time in the reorganization process when it is in the public interest that litigation should be finally ended. Hence, unless specific provision is made otherwise, the final decree—which concludes the proceeding and closes the estate—discharges and terminates every right against and interest in the debtor of every kind, including liabilities incurred during reorganization, and including even the holders of claims or interests not filed or scheduled in the proceeding or who had no notice of it.

* * * * *

"The confirmed plan, as we have seen, binds everyone, and consistent with this, the discharge must terminate all manner of claims or interests, else the reorganized business will be hampered at the outset with holdover obligations which will defeat the very purpose of the proceeding." (6 Collier on Bankruptcy (14th Ed.) Sec. 11.18, pp. 3922-24)

and to railroad reorganizations

"We are in complete agreement with the observations made by the district court in its opinion dismissing appel-

⁴⁹This makes it clear that Corporation could have filed its claim. The 1943 returns which first claimed the stock loss deduction were filed July 15, 1944 (Exs. P. 4A, 4B). The last of the returns were filed June 15, 1945 (Exs. P. 5A, 5B). The reorganization proceeding remained open until March 28, 1946 (Ex. D. 32, R. 2013). Even if it were argued that the claim did not mature until the tax liability was settled, it had in the meantime been "executory or contingent, presently due or to mature in the future" and therefore it should have been filed.

lant's action to the effect that the purpose of the bankruptcy law and the provisions for reorganization could not be realized if the discharge of debtors were not complete and absolute; that if courts should relax the provisions of the law and facilitate the assertion of old claims against discharged and reorganized debtors, the policy of the law would be defeated; that creditors would not participate in reorganizations if they could not feel that the plan was final; and that it would be unjust and unfair to those who had accepted and acted upon a reorganization plan if the court were thereafter to reopen the plan and change the conditions which constituted the basis of its earlier acceptance." (*Duryee v. Erie R. Co.*, 175 F.2d 58, 63 (C.A. 6, 1949) cert. den. 338 U.S. 861.)⁵⁰

Appellants propose to flout these settled purposes of a reorganization. They ask this Court to declare that the reorganized company did not emerge from the reorganization proceeding with its liabilities defined; that on the contrary and in spite of efforts extending over a period of eleven years by the Interstate Commerce Commission, by the court below, by this Court and the Supreme Court, the company emerged from reorganization with an undefined and undisclosed liability of \$17,201,739.00, a liability, moreover, to be paid in cash by a reorganized company whose first mortgage bond issue was limited to \$10,000,000 and which was permitted to have no other fixed interest charge. This suggestion, if accepted, would render ridiculous the efforts in the reorganization to define the liabilities of the new company. No court has ever intimated that the fundamental purposes of a reorganization could thus be frustrated and defeated.

⁵⁰See also: *McColgan v. Maier Brewing Co.*, 134 F.2d 385 (C.C.A. 9, 1943) cert. den. 320 U.S. 737; *Black v. Richfield Oil Corp.*, 146 F.2d 801 (C.C.A. 9, 1944) cert. den. 325 U.S. 867; *In re Colorado & S. R. Co.*, 84 F. Supp. 134 (D.C. Colo. 1949) cert. den. 338 U.S. 847; *Beckley v. Erie R. Co.*, 175 F.2d 64 (C.A. 6, 1949); *Standard Steel Works v. American Pipe & Steel Corp.*, 111 F.2d 1000 (C.C.A. 9, 1940); *North American Car Corp. v. Peerless W. & V. Mach. Corp.*, 143 F.2d 938 (C.C.A. 2, 1944); *In re Peyton Realty Co.*, 148 F.2d 771 (C.C.A. 3, 1945); *Mohonk Realty Corp. v. Wise Shoe Stores*, 111 F.2d 287 (C.C.A. 2, 1940).

B. An Unauthorized and Unapproved Claim for Payment of an Administrative Expense Cannot Be Enforced.

If appellants' claim were a claim against the debtor, it would be barred by the specific provisions of Section 77(f).⁵¹ As a claim for payment of an expense of the reorganization proceeding, it is in no better position.

1. A COURT TRUSTEE CAN INCUR NO LIABILITY WITHOUT COURT APPROVAL AND SECTION 77 AND THE ORDERS IN THE WESTERN PACIFIC REORGANIZATION SO PROVIDE.

The reorganization trustees, as court officers, had no power to incur any liability to appellants for a "tax saving" payment or otherwise except by express authorization of the reorganization court. This is settled. "The receiver being an officer of the court, and acting under the court's direction and instructions, his powers are derived from and defined by the court under which he acts. He is not such a general agent as to have any implied power, and his authority to make expenditures and incur liabilities—like the one in question—must be either found in the order of his appointment, or be approved by the court, before they acquire validity, and have any binding force upon the trust." *Chicago Deposit Vault Co. v. McNulta*, 153 U.S. 554, 561, 14 S.Ct. 915, 918 (1894); *Farmers' Loan & Trust Co. v. Central Railroad Co.*, 7 Fed. 537, 539 (C.C., D. Ia. 1880). The rule is strictly applied. In *Northern Finance Corp. v. Burns*, 5 F.2d 11 (C.C.A. 8, 1925), a receiver without prior authority borrowed funds to pay taxes due from the estate. The claim of the lender for the amount of the

⁵¹Section 77(f) reads in part:

"The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of all claims of the debtor, its stockholders and creditors, and the debtor shall be discharged from its debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention, * * *."

loan was denied. In *Byrnes v. Missouri National Bank*, 7 F.2d 978 (C.C.A. 8, 1925), a receiver, authorized to borrow \$150,000.00, borrowed an additional \$2,000.00. A claim for the \$2,000.00 was disallowed. In *In re Erie Lumber Co.*, 150 Fed. 817 (S.D. Ga. 1906), merchants furnished goods to a receiver who had no court authority to buy. They were denied compensation. In *Union Trust Co. v. Illinois Midland Co.*, 117 U.S. 434, 6 S.Ct. 809 (1886), the Supreme Court invalidated a claim for \$29,000.00 created by a receiver without prior court approval.

This principle requiring court sanction to create a liability of the estate was approved by Congress for railroad reorganizations. Section 77(e) says that the reorganization plan must provide "*for the payment of all costs of administration and all other allowances made or to be made by the judge.*" And it was expressly recognized in the Western Pacific proceeding. The reorganization court (Ex. D. 20, R. 1908), authorized the debtor to continue its railroad business and provided:

"The authority given by the foregoing shall not include authority to incur expense, other than such as is necessary in the course of the usual and ordinary maintenance and operation of the debtor's property. *Any extraordinary expense* and expense incident to reorganization of the debtor *shall be subject to the prior approval of the Court.*" (R. 1910) (Emphasis supplied.)

This provision was affirmed in the order appointing the reorganization trustees and transferring the railroad properties to them (Exs. D. 21, D. 22, R. 1916, 1923). An unprecedented liability of \$17,201,739.00 is certainly an "extraordinary expense." As such, it could not be incurred without "the prior approval of the Court." No such approval was provided. Accordingly, appellants' claim never became a valid obligation of the trustees or the estate. To obtain strict judicial supervision of all expenses connected with a reorganization was one reason for

substituting Section 77 for the traditional equity receivership. *Leiman v. Guttman*, 336 U.S. 1, 69 S.Ct. 371 (1949). The policy is extremely rigid—so much so that it has been extended to fees and allowances which are not to be paid from the assets of the estate. *Leiman v. Guttman*, *supra*. Appellants ask this Court to repudiate this firm policy.

2. THIS COURT HAS SPECIFICALLY HELD THAT UNAPPROVED CLAIMS FOR ADMINISTRATIVE EXPENSES CANNOT BE ENFORCED.

In *McColgan v. Maier Brewing Co.*, 134 F.2d 385, 387 (C.C.A. 9, 1943) this Court said:

“Upon confirmation of the plan for composing the debts of the Maier Brewing Company, the receiver was discharged and the property unconditionally turned back to the corporation. Does the property so returned remain liable for debts incurred by the receiver in the course of administration? We understand not, unless the court has so directed.”

In that case properties of the Maier Brewing Company were operated by a bankruptcy receiver from June, 1932, until September, 1938, when, following the approval of a plan of composition, they were returned to the company. In December, 1940, creditors of the company petitioned for a Chapter X reorganization and a trustee was appointed. In the reorganization proceeding the California State Franchise Tax Commissioner filed claims for franchise taxes due for the taxable years 1933 to 1937 inclusive. It was recognized that these taxes were an expense of administration of the earlier receivership but the Court held that since the California Commissioner had not filed a claim in that receivership they could no longer be collected. The Court said:

“Of course if these taxes had been assessed and a claim made upon the receivers for their payment they would, like administrative expenses generally, have occupied a preferred status. But the statute does not dispense with the necessity for making timely demand for their payment in

the receivership proceeding. As much now as in the past orderly procedure requires that administrative expenses be settled while the property yet remains in the custody of the court." (134 F.2d 388.)

Every consideration which influenced this Court in the *McColgan* case is equally applicable in this proceeding. Here, as there, the orderly administration of the estate requires that claims for administrative expense be filed. Here, as there, the new investors in the new company are entitled to have a precise definition of the liabilities of that company. Here, as there, the persons who participate in the reorganization as creditors or otherwise are entitled to an exact statement of the assets available for the new concern. Compare the recent three-judge court decision in *In re Colorado & S. R. Co.*, 84 F. Supp. 134 (D.C. Colo. 1949) cert. den. 338 U.S. 847, in which it was held that claims of the United States for taxes for periods prior to and during the reorganization were both barred by a failure to present them.⁵²

The cases are clear. A claim for payment of an administrative expense must be presented, if it is to be paid, to the court in charge of the administration. Appellants failed to present their claim. It cannot be paid.

3. THE ASSUMPTION AGREEMENT DOES NOT PROVIDE FOR PAYMENT OF APPELLANTS' CLAIMS.

In the fall of 1944 and after the railroad properties had been operated by the trustees for nine years, the reorganization was sufficiently near completion to justify a return of the properties to the reorganized company. On November 27, 1944, the reor-

⁵²In the court below appellants relied upon *Texas and Pacific Railway Co. v. Johnson*, 151 U.S. 81, 14 S.Ct. 250 (1894) and *Texas and Pacific Railway Co. v. Bloom*, 164 U.S. 636, 17 S.Ct. 216 (1897), two cases arising out of a single railroad receivership in which it was held that the old company was responsible for the debts of the receiver. The decisions are explained by the fact that the properties were returned without any reorganization taking place.

ganization court directed the revestment effective as of December 31, 1944 (Ex. P. 14, R. 1711, 36-108). It was contemplated, of course, that the trustees would thereafter be discharged. Since all assets of the estate were to be transferred to the new company, some provision had to be made to find funds for the actual payment of the approved and outstanding obligations of the trustees. Under such circumstances it is conventional for the new company to provide the funds required to pay the trustees' recognized debts and the reorganization court directed the execution of an agreement so providing. The language was broad in order to give the trustees full protection against personal liabilities after they had completed their duties and received their discharge.⁵³ The contention of appellants is that the obligation to make "tax savings" payments was "an obligation incurred by the Trustees in their operation of the debtor's estate and was an obligation assumed by the defendant * * *" (Supp. Compl. par. Eleventh, R. 224). Appellants argued in their trial briefs that the assumption agreement relieved them of the necessity of presenting their claim to the reorganization court. The suggestion is not repeated. In any event, it has no validity. There are many reasons.

First. The purpose of the assumption agreement was to provide money for the discharge of recognized debts and to provide the trustees with personal protection. It was not to undo all the work of the reorganization by giving validity to an undisclosed claim of \$17,000,000.00.

Second. The reorganization court, in directing the execution of the assumption agreement, did not eliminate the necessity that expenses of administration be approved by the court. On the contrary it expressly reaffirmed that requirement. Paragraph 10 of the order of November 27, 1944, directing the execution of the assumption agreement, provides in part:

⁵³For the text of the assumption agreement see R. 77-78.

"10. The Western Pacific Railroad Company shall pay, *in such amounts as have heretofore been, or shall hereafter be determined by this Court*, but only to the extent that the same shall not have been paid by the debtor's Trustees, *all expenses and costs of administration of this proceeding*, * * *" (Emphasis supplied.) (R. 50.)

Third. Appellants' argument is, in effect, that the reorganized company agreed to assume and discharge *all* obligations of the trustees. The reorganization court made it clear, however, that the assumption agreement should not be so understood. In directing the execution of the agreement the Court described it as follows:

"(a) agreement providing for the assumption of *certain* obligations, liabilities, contracts, agreements and leases of the debtor and the debtor's Trustees, * * *" (R. 46)

and went on to say:

"* * * and said Railroad Company shall assume only the *valid and outstanding obligations and liabilities of the debtor or the debtor's Trustees*, * * *" (Emphasis supplied.) (R. 50)

The references in the order to "*certain* obligations" of the trustees and to "*the valid and outstanding obligations*" of the trustees make it clear that it was never intended that the assumption agreement should obligate the reorganized company to pay *all* obligations of the trustees.

Fourth. Since the result of appellants' failure to obtain court approval of their claim is that the claim never became an obligation of the trustees (this brief p. 68), appellants could not recover even if the assumption agreement were construed to refer to all trustee obligations.

Fifth. The reorganization court had no power and it did not intend by the assumption agreement to eliminate the requirement of Section 77(e) that costs of administration be approved by the court.

Sixth. The reorganization court had no power and it did not intend by the assumption agreement to violate the requirement of the plan of reorganization that

"Claims against the debtor, entitled to priority over any mortgage of the debtor, *current liabilities and obligations incurred by the trustees of the properties of the debtor during the reorganization proceeding*, and expenses of reorganization allowed by the court within the maximum fixed by this Commission shall be paid in cash or assumed by the reorganized company, * * *. The reorganized company shall be deemed to have assumed the executory contracts of the debtor which by their terms do not terminate at or prior to the conclusion of the reorganization proceeding and which shall have been affirmed or shall not have been disaffirmed by the trustees of the properties of the debtor with the approval of the court prior to the confirmation of the plan, and also any executory contracts made by the trustees of the properties with the approval of the court which by their terms do not terminate at or prior to the conclusion of the reorganization proceeding." (Emphasis supplied.)

(Subdivision Q, Western Pacific R. Co. Reorganization, 233 I.C.C. 409, 452-3.)

Appellants' claim if presented to the reorganization court would have been a claim of the right to an executory contract with the trustees for payment of "tax savings." Subdivision Q required specific court approval. The provision for "current liabilities and obligations" refers to obligations which arise in the ordinary course of business and are payable currently.⁵⁴ It contemplates

⁵⁴In *Lackawanna Iron & Coal Co. v. Farmers' Loan & T. Co.*, 176 U.S. 298, 316, 20 S.Ct. 363, 369 (1900), the Supreme Court distinguished current debts from "extraordinary expenditures outside of the ordinary course of business * * *."

Representative definitions of "current liabilities" are:

Securities and Exchange Commission (Regulation S-X, Rule 3.14):

"All amounts due and payable within one year shall in general be classed as current liabilities."

Accountant's Weekly Report, Vol. 6, No. 1 (Sept. 29, 1947):

" 'Current Liabilities' means 'debts or obligations, the liquidation

that such liabilities and obligations would be incurred with the sanction of the reorganization court and in any event it could not refer to an extraordinary claim such as this.

An assumption agreement in a reorganization proceeding has a limited and well understood purpose. It operates within and not beyond the framework of the reorganization. It does not give validity to claims otherwise invalid or give vitality to claims which have been barred.

C. Appellants' Claim Is Barred and Enjoined by the Final Orders of the Reorganization Proceeding.

The revestment order of November 27, 1944 (Ex. P. 14, R. 36), and the final order of March 28, 1946 (Ex. D. 32, R. 2013) each contain provisions of discharge and injunction. Those provisions bar appellants' claim. The revestment order provided (Par. 11, Ex. P. 14, R. 51-52) that the assets of the reorganized company were to be:

"free and clear of all rights, claims, liens and interests of said Trustees, the former stockholders and creditors of the debtor, and of all other persons * * * except as is otherwise provided in this order, and the said Railroad Company shall thereupon be forever released and discharged from all of its debts, obligations and liabilities, except as herein provided;"

Paragraph 15 of the same order enjoined all persons from:

"15. * * * in any manner whatsoever disturbing any part of the assets, goods, moneys, railroad, properties and premises belonging to or in the possession of said Railroad Company * * * by reason of or growing out of any obligation or obligations heretofore incurred by the debtor *or the debtor's Trustees herein.*" (R. 59-60) (Emphasis supplied.)

or payment of which is reasonably expected to require the use of existing resources properly classifiable as current assets or the creation of other current liabilities."

Thus, the assets of the reorganized company were discharged from and by injunction protected against the assertion of any claim, except as expressly reserved, arising out of an obligation of the trustees. No provision in the order protects and conserves unapproved claims for payment of administrative expenses. On the contrary by paragraph 20 of the order (R. 61-62) the reorganization court expressly reserved jurisdiction to consider and determine the validity of any such claim as appellants now present:

"* * * and this Court expressly reserves jurisdiction to determine all costs and expenses of administration * * *."
(Ex. P. 14, R. 62)

The effect of the revestment order is clear. With certain reservations, it barred all claims against the reorganized company on account of obligations of the trustees, expressly reserving to the court, however, the power to consider and approve claims for payment of expenses of administration.

The reorganization proceeding was not closed until March 28, 1946 (Ex. D. 32, R. 2013), long after all the tax returns in issue here had been filed (Exs. P. 5A, 5B). Appellants never took advantage of the opportunity to present their claim. Accordingly and in due course the court by its final order permanently enjoined the assertion by appellants or anyone else of any such claim as is here presented. Paragraph 6 (Ex. P. 32, R. 2017-18) of that order provides:

"All persons * * * are hereby perpetually restrained and enjoined from instituting * * * against The Western Pacific Railroad Company * * * directly or indirectly, on account of or based upon any right, claims or interest of any kind or nature whatsoever which any such person, firm or corporation may have had in, to or against the Debtor, or any of its assets or properties, on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), * * * and from interfering with

or taking steps to interfere with said Company, its officers and agents, or the operation of the lines of railroad or properties or the conduct of the business of said Company, by reason or on account of any obligation or obligations incurred by the Debtor or by the Trustees of the Debtor's estate on or before December 28, 1944 (except as specifically provided for or permitted by prior order of this Court), and * * * from prosecuting * * * against the said Company, its agents or attorneys, any suit or proceeding arising out of, or based on, any act or acts done or omitted to be done in putting into effect and carrying out the plan of reorganization or any order of this Court entered in these proceedings."

Appellants' claim is squarely within and in violation of the injunctive provisions of this order. Paragraph 6 protects the reorganized company from claims based upon obligations of either the debtor or the reorganization trustees, except as specifically approved or expressly reserved. This claim is a claim based upon an alleged obligation of the trustees which was neither approved nor reserved.⁵⁵ It is therefore enjoined.

The reorganization proceeding is a complete and insurmountable bar to any recovery by appellants in this action. It is a bar because appellants' claim is contrary to the policy of Section 77

⁵⁵The reference in the order to December 28, 1944, is of no assistance to appellants. From and after that date the railroad properties were to belong to and be operated by the reorganized company. Thus, by reference to claims "by reason of or on account of any obligation or obligations incurred by the debtor or by the trustees of the debtor's estate on or before December 28, 1944," the court referred to the entire period of trustee operation and plainly intended to foreclose all claims arising out of or in any way connected with that operation. "Tax saving" claims relating to 1942, 1943 and 1944 taxes relate to the period of trustee operation, that is, to the period prior to December 28, 1944. As such they are within the injunctive provisions of Paragraph 6.

Any possibility of doubt as to the intent of the final order is removed by the fact that the District Judge who signed the order subsequently construed it to bar claims arising during the reorganization period. See in the files of this Court *In the matter of The Western Pacific Railroad Company, Debtor*, No. 12159.

and the purpose of the Western Pacific reorganization itself. It is a bar because of the settled rule that a claim for payment of an expense of administration which is not allowed by the court in charge of the estate has no validity. It is a bar because the reorganization court by specific provision has enjoined the assertion of any such claim.⁵⁶

D. The Court Below Was Without Power to Modify Orders of the Reorganization Court.

Appellants have asked in their pleadings (R. 123-154) that, if necessary, there be "a modification of" the final order of the reorganization court "so as to permit the prosecution of" their alleged cause of action (R. 154). There is no power, however, in this Court, or in the District Court sitting in equity, to modify the final order or any other order entered in the reorganization proceeding. Bankruptcy jurisdiction is exclusive. No court other than a court sitting in bankruptcy has jurisdiction to alter,

⁵⁶Appellants' failure to present their "tax saving" claim in the reorganization proceedings also bars the claim under principles of *res judicata*. A litigant who asserts claims against an estate in the hands of a court must in the first proceeding assert all of his claims or be forever foreclosed. *United States v. California & Ore. Land Co.*, 192 U.S. 355, 24 S.Ct. 266 (1904); *Northern Pacific Railway Co. v. Slaght*, 205 U.S. 122, 27 S.Ct. 442 (1907); *Montezuma Canal v. Smithville Canal*, 218 U.S. 371, 31 S.Ct. 67 (1910); *Estate of Bell*, 153 Cal. 331, 95 Pac. 372 (1908); *Krier v. Krier*, 28 C.2d 841, 172 P.2d 681 (1946).

The claim for 1943 is also barred by the statute of limitations. The 1943 returns took advantage of the loss of the Corporation (Exs. P. 4A, 4B, D. 40). They were filed July 15, 1944 (Exs. P. 4A, 4B). More than two years later, on October 10, 1946, this action was filed (R. 5). California law determines the applicable period of limitation, *Guaranty Trust Co. v. York*, 326 U.S. 99, 65 S.Ct. 1464 (1945), and since this is an unjust enrichment action the two-year statute of Subdivision 1 of Section 339 of the California Code of Civil Procedure is applicable. *Richter v. Henningsan*, 110 Cal. 530, 538, 42 Pac. 1077 (1895); *Bray v. Cohn*, 7 C.A. 124, 93 Pac. 893 (1907); *Trower v. City and County of San Francisco*, 157 Cal. 762, 767, 769, 109 Pac. 617 (1910); *Jacobson v. Mead*, 12 C.A.2d 75, 81, 55 P.2d 285 (1936); *Lazzarevich v. Lazzarevich*, 88 C.A.2d 708, 200 P.2d 49 (1948). This is true even though the action is filed in equity. 16 Cal. Jur. 429, *Williams v. Southern Pacific R. Co.*, 150 Cal. 624, 89 Pac. 599 (1907); *Bell v. Bank of California*, 153 Cal. 234, 94 Pac. 889 (1908).

modify or amend bankruptcy orders. This is settled. *In re Watts and Sachs*, 190 U.S. 1, 27, 23 S.Ct. 718 (1903); *Isaacs v. Hobbs Tie & T. Co.*, 282 U.S. 734, 739, 51 S.Ct. 270, 272 (1931); *Moore v. Scott*, 55 F.2d 863, 864-65 (C.C.A. 9, 1932); *Hanna v. Britson Mfg. Co.*, 62 F.2d 139, 145 (C.C.A. 8, 1932).

CONCLUSION

It is respectfully submitted that the judgment below should be affirmed with costs to the appellees.

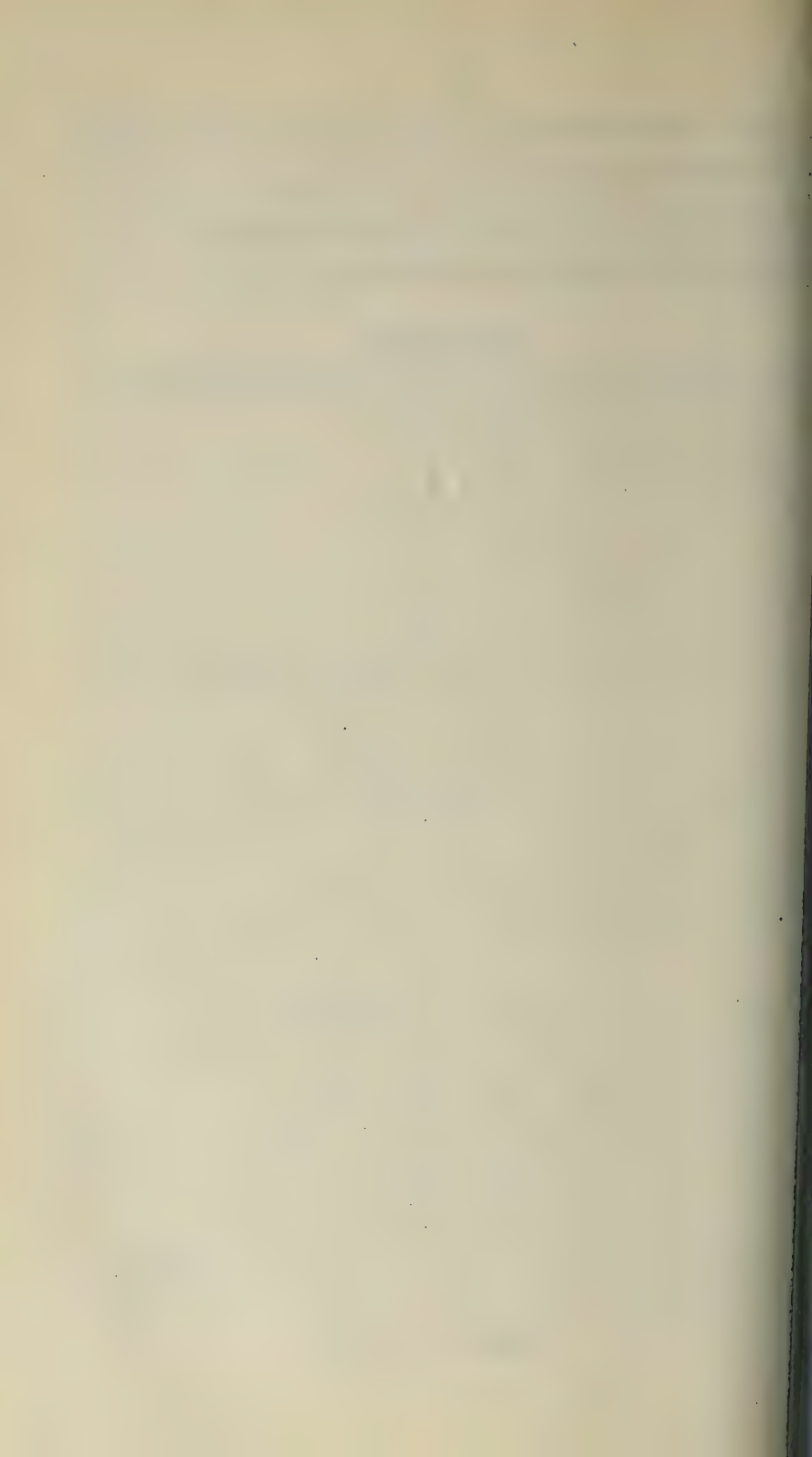
Dated: November 15, 1950.

ALLAN P. MATTHEW,
JAMES D. ADAMS,
ROBERT L. LIPMAN,
BURNHAM ENERSEN,
WALKER LOWRY,
MCCUTCHEEN, THOMAS, MATTHEW,
GRIFFITHS & GREENE,
1500 Balfour Building,
San Francisco 4, California
*Attorneys for The Western Pacific
Railroad Company, et al.,*

Appellees;

EVERETT A. MATHEWS,
PILLSBURY, MADISON & SUTRO,
225 Bush Street,
San Francisco 4, California
A. DONALD MACKINNON,
MILBANK, TWEED, HOPE & HADLEY,
15 Broad Street,
New York 5, New York
FORBES D. SHAW,
WHITMAN, RANSOM, COULSON & GOETZ,
40 Wall Street,
New York 5, New York
Attorneys for Western Realty Company,
Appellee.

(Appendices follow)





Appendix A

WESTERN PACIFIC RAILROAD CORPORATION

Schedule of Directors and Terms of Service 1941 to February, 1948

<i>Name</i>	<i>Period of Service on Board</i>
E. M. Schumacher	August 1, 1935 until his death on February 26, 1948 (R. 638).
W. W. Kingsley	August 1, 1935 until his death on September 7, 1942.
W. W. Carman	August 1, 1935 to February 1, 1942.
M. J. Curry	August 1, 1935 to present date.
F. J. Shepard	August 1, 1935 until his death on August 22, 1942.
R. E. Coulson	August 1, 1935 to February 6, 1942.
W. D. Wood	August 1, 1935 to present date.
J. K. Olyphant, Jr.	January 7, 1937 to December 18, 1941.
A. P. Osborn	January 7, 1937 to present date.
R. M. Price	January 7, 1937 until his death on April 7, 1941.
H. B. Campbell	July 5, 1940 to May 1, 1945.
J. F. Wienken	April 29, 1942 to April 25, 1946.
W. W. Hatton	September 23, 1942 to present date.
C. C. Sheehan	February 15, 1944 to October 10, 1946.
M. C. Valouch	May 1, 1945 to present date.
F. C. Nicodemus, Jr.	October 10, 1946 to present date.

(Ex. P. 22, R. 1720)

WESTERN PACIFIC RAILROAD CORPORATION

Schedule of Officers and Terms of Service 1935 to February, 1948

<i>Name</i>	<i>Office</i>	<i>Period of Service</i>
E. M. Schumacher	President	August 1, 1935 to Feb. 1, 1942
M. J. Curry	Secretary	August 1, 1935 to Feb. 1, 1942
F. J. Curry	Treasurer	August 1, 1935 to present date
F. J. Curry	President	February 1, 1942 to present date
J. F. Wienken	Secretary	February 1, 1942 to May 1, 1945
M. C. Valouch	Vice-President and Secretary	May 1, 1945 to present date

(Ex. P. 21, R. 1719)

Appendix B

I. MATERIAL FROM THE FEDERAL TRADE COMMISSION

A. Report of the Federal Trade Commission on Public Utility Holding Companies.¹

The Public Utility Holding Company Act of 1935 resulted in part from an investigation of the practices of public utility holding companies by the Federal Trade Commission. The report of the Commission reads, in part, as follows:

Income of holding companies due to methods of handling Federal income-tax payments.—Some holding companies have collected from their respective subsidiary companies funds with which to pay Federal income tax for all the companies in a group. The total amount of funds collected by the holding companies from the subsidiaries usually exceeded the amounts actually paid by the holding companies. This practice has resulted in an unusual, if not unjustifiable, means of income to those holding companies engaging in this practice.

During 1923 to 1929, inclusive, The North American Co., from this practice, recorded 1.6 percent of its total income, and Associated Gas & Electric Co. recorded 3.3 percent of its total income. While New England Power Association, in effect, followed this practice, it added the excess amounts so collected to a suspense account and not to income. Cities Service Co. added the amounts collected in following this practice to surplus and related accounts.

Some State commissions engaged in the regulation of gas and electric public-utility companies have permitted operating com-

(1) Summary Report of the Federal Trade Commission to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.

panies to add the estimated amounts of Federal income tax to operating expenses. These estimated amounts are then, in many cases, paid to a holding company, which, in turn, files a consolidated Federal income-tax return. Any saving in tax accomplished through the consolidated return accrues to the gain of the holding company and is retained.

The fact that holding companies retain the difference between the amounts collected from subsidiaries and the amounts paid as income tax indicates that holding companies have not tried to pass on to their subsidiaries the savings which evolve from the corporate structure of holding-company groups. Instead of subsidiary operating companies having this saving, the operating expenses of those companies are inflated by such amounts. The original amounts charged to subsidiary companies were estimated on a basis of what those companies would have had to pay if individual income-tax returns had been made. Inasmuch as the amounts for Federal income tax should never have been added to operating expenses in the first place and were only estimated amounts, anyway, and also, since the amounts were in excess of the Federal income-tax requirements of the group, it would seem that due to this practice there is an inaccurate recording of the true cost of operations of the electric and gas operating companies following this procedure.

In order to emphasize the extent of collections of estimated amounts for Federal income-tax payments from subsidiary companies, by certain holding companies, over the amounts of Federal income tax paid by those holding companies, some illustrations are given.

One illustration of this procedure appears in the report on New England Power Association. During 1928 and 1929 the subsidiary companies paid to New England Power Association, on the basis of individual Federal income-tax returns, \$376,971.36 in excess of the amount of Federal income tax paid by the hold-

ing company on the basis of consolidated income-tax returns.

During the years from 1926 to 1929, inclusive, Associated Gas & Electric Co. recorded a gain, due to this procedure of handling Federal income tax, of \$2,938,513.12. It is significant to note that Associated Gas & Electric Co. paid no Federal income tax whatever during the years from 1926 to 1929, inclusive, although, of course, Associated Gas & Electric Co. may be subject to assessments in subsequent years for the said period. Also, New England Gas & Electric Association, affiliated with Associated Gas & Electric Co., recorded during 1927 to 1929, inclusive, as income \$514,662.99 on the basis of the plan explained above, but no Federal income tax was paid by New England Gas & Electric Association to the United States Government.

An outstanding illustration of this procedure is shown in the report on Cities Service Co. During the years from 1922 to 1930, inclusive, Cities Service Co. collected from its subsidiaries \$11,611,601.35 for Federal income taxes. During this period, Cities Service Co. paid Federal income taxes on the basis of a consolidated income-tax return in the sum of \$1,745,220.98. The excess amount collected over the amount paid by Cities Service Co. was \$9,866,380.37.

As a further illustration, The North American Co. recorded as income \$324,915.17 in 1927, \$675,000 in 1928, and \$275,000 in 1929, or a total of \$1,274,915.17 in the 3 years, from handling Federal income-tax payments in the manner previously described.

This Commission considers that there should not be added to operating expenses of electric and gas utility companies any amounts paid as Federal income tax. The amounts paid as Federal income tax should be deducted from the net income on which the tax was calculated.

Holding companies are not justified in recording as income the savings from this procedure of handling Federal income-tax

payments. The subsidiary companies in a holding-company group are entitled to the benefit of any savings to the group due to filing a consolidated income-tax return. Only the amount of Federal income tax paid by a holding company on the basis of a consolidated return should be borne, in proportion to the taxable income, by those companies having taxable income, for which companies a consolidated return was filed. Stated differently, each company in a holding-company group should pay only its pro-rata share of the tax paid for the group. Then no gain from this source would be derived by holding companies.

The pro-rata amount of the total Federal income tax, paid by an operating subsidiary company, should be properly treated on the books of the operating companies. These amounts are not a part of the costs of producing and distributing electric energy or gas (pp. 477-479).

*The Commission further stated:*²

(2) *Direct Statutory Inhibitions*

The more usual and long-established method of legislation which directly and specifically prohibits certain practices, with proper penalties, cannot be overlooked in discussing remedies for the present utility holding company situation. This means that a separate statute should be drawn which makes felonies or misdemeanors of the disclosed abuses so far as they may be reached under Federal jurisdiction. That is to say, it would apply to all utility corporations or their holding companies and affiliates or subsidiaries which are engaged in interstate commerce or which directly affect such commerce. It is believed such legislation can be made to cover situations where a holding company controls in any degree the acts and policies of cor-

(2) Summary Report of the Federal Trade Commission to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Holding and Operating Companies of Electric and Gas Utilities, Part 73-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.

porations in different States although no one of them operates in more than one State. The privilege of the mails may also be denied as to all matter and transactions intended to promote or carry on the enumerated abuses.

The recommendations immediately following relate primarily to protection of the rate-paying public.

* * * 5. A proper amendment to the Federal income-tax law to prevent collection of anticipated income taxes from operating subsidiaries by holding companies and nonpayment to the Government; also to prevent evasion of such taxes through various forms of so-called "reorganizations", carried on largely within the holding company groups and often primarily for the purpose of such avoidance. In a single instance such avoidance involved a cash profit of over \$9,000,000 (pp. 69-70).

II. MATERIAL FROM THE SECURITIES AND EXCHANGE COMMISSION

A. Excerpts from Securities and Exchange Commission Release No. 53, Accounting Series:

For Release in MORNING Newspapers
of Friday, November 16, 1945

SECURITIES AND EXCHANGE COMMISSION Philadelphia

Securities Act of 1933

Release No. 3100

Securities Exchange Act of 1934

Release No. 3750

Public Utility Holding Company Act of 1935

Release No. 6200

Accounting Series

Release No. 53

IN THE MATTER OF "CHARGES IN LIEU OF TAXES"

* * * * *

VI

THE TREATMENT OF "TAX SAVINGS" IN FINANCIAL STATEMENTS FILED WITH THIS COMMISSION

Cases involving the treatment of so-called "tax savings"²³ in

(23) We think it undesirable in principle and possibly misleading to refer to this problem as involving "tax savings" although due to the general use of the term in this sense we have adopted that nomenclature here. It seems to us that the term "tax saving" is apt to connote some sort of standard or normal tax law and a standard or normal earnings year to which that law applies. The facts are, of course, that there has not been static or standard or "normal" tax law or tax status; nor has it been possible except in most unusual cases to characterize any particular fiscal year of a company as a "normal earnings" year, from which all others are to be regarded as departures. Under such conditions, each year's tax is whatever happens to result from the application of the computation formula, provided by the tax law of that year, to the sum total of taxable transactions and tax deductions resulting from whatever business may have been done in that particular year. Moreover, the past few years during which the term and the problem of "tax savings" appeared have clearly been unusual in nearly every respect. Finally, if the phenomenon in question is to be described as a "tax saving" it would seem necessary to describe as a "tax loss" the failure to carry through a transaction which it can be said would have resulted in a "tax saving." And if taxes in one year are higher should not that increase itself be considered to be a "tax loss." Our strong preference is to describe the problem as involving "tax reductions."

financial statements have arisen with increasing frequency in recent months. For that reason, as stated earlier, we feel it desirable to state our views as to the treatment to be accorded such items in statements filed with us and to point out the reasons which have led us to those conclusions.

* * * * *

We now examine the contention that income taxes should be allocated "as other expenses are allocated." The accountants who appeared before us cited to us no other expense which, for general accounting purposes, is allocated in the manner proposed for income taxes, nor have any such instances otherwise come to our attention. We note, moreover, that in a dissent to the bulletin mentioned earlier it was stated:

"No expense other than federal income and profits taxes is allocated on the basis of applying to a given transaction so much of the expense as would not have occurred if the transaction to which the expense is attributed had not taken place. The usual method is to allocate a total expense ratably to given accounts or transactions on a consistent basis."

The illustrations of expense allocation cited to us by the certifying accountants in this case appear to us to support the above statement. In each case cited there was an expense actually incurred that was first allocated to the period under the usual accrual principles and then distributed over a number of accounts. In no case was there an estimate made of what the expense would have been under other conditions. In no case cited, was there a distribution of an expense to several accounts by means of what can be termed an algebraic formula in which a negative sum is credited against one item to offset the positive charge to another item of an amount in excess of the actual expense. We do not regard such a treatment as an appropriate means of allocating income taxes in financial statements which

purport to reflect the actual results of operations. We have doubt indeed that such a method can properly be termed an allocation at all, as that term is customarily used.

We note, in passing, moreover, that in the examples of expense allocation cited to us there existed a direct, almost physical association between the item being allocated and the item to which it was charged. For example, in the case of real estate taxes allocated to construction the tax item is directly and closely related to the construction. Likewise, in the case of brokerage fees, and stamp or transfer taxes, the tax item is closely and directly related to the specific transaction. *In both cases, moreover, the tax is independent of any other transactions of the company.* Nor is there any attempt made to increase in the course of the allocation the amount of such taxes to an estimated sum. We feel therefore that such illustrations can not properly be cited in support of the proposed treatment for income taxes.

It is also sometimes pointed out that "cost" in the case of securities or property acquired is generally considered to be the sum of the purchase price plus incidental costs such as brokerage and any specific taxes paid by the buyer and that on sale the proceeds are computed as the selling price less incidental deductions such as commissions or any specific taxes paid by the seller. By analogy and in justification of the proposed treatment of income taxes it is frequently urged that a so-called "tax saving" must be allocated or attributed to or ultimately associated with particular losses or expenses because the tax consequences of the transaction involving the loss or expense were a motivating factor in arriving at the decision to consummate it. Thus, it is claimed that a property would not have been sold but for the "tax saving" thereby effected and that for this reason it is proper to consider that the true "loss" on the sale is not the excess of cost over selling price but is equal instead to the difference

between cost on the one hand and selling price *plus* "tax saving" on the other. We do not believe such an analogy is sound and we cannot accept that analysis as a basis for reporting the results of actual operations. It is undoubtedly true that the tax consequences of selling a property often are an important consideration in arriving at the decision to sell, and may in some cases have been a deciding factor. However, tax consequences undoubtedly play an important role in the making of a great variety of decisions involving the incurrence and amounts of purely operating expenses such as advertising, wage rates and bonus plans. Yet it can hardly be argued that wages or bonuses or advertising are to be reported as less in amount because income taxes would have been higher if the amounts spent on such items were less. We see no basis for adopting a different approach in figuring the "loss" involved in a sale of property. We feel instead that there has been a loss of the full difference between cost and selling price coupled with a tax benefit which is properly reflected in the lower taxes actually paid. We feel that the proposed treatment of income taxes tends to obscure these facts and that the treatment of income taxes required by our rules and heretofore almost universally followed clearly discloses what has taken place. Where the tax paid for the year is unusual in amount because of unusual conditions, an appropriate explanation would be called for as is now required in the case of other unusual events.

As to this last principal contention urged by the certifying accountants (that income taxes are an expense that should be allocated as other expenses are allocated) we feel, first, that there is grave doubt whether income taxes can properly be considered as an expense in the same category as the cost of materials or wages, and, second, that the treatment proposed does not result in the allocation of income taxes "as other

expenses are allocated." We feel instead that the proposed treatment is purely an effort to have items shown in the income statement at what is considered to be a "normal" amount. We note that this objective is clearly expressed as a prime purpose of the method in the bulletin referred to earlier which states at p. 185:

"As a result of such [unusual] transactions the income tax legally payable may not bear a *normal* relationship to the income shown in the income statement and the accounts therefore may not meet a *normal* standard of significance." (Emphasis supplied)

There are, finally, a number of difficulties involved in the proposed treatment of income taxes that deserve mention even though they are not directly related to the specific contentions put forward by the certifying accountants in the case.

The first involves the preparation of general statistical data from financial reports. Under the method proposed, it is permissible to show, as taxes, an amount in excess of the taxes payable. If such items are totalled for a period of years or for groups of companies, they may well be used as evidence of the aggregate amount of taxes paid by the company or by the industry. Obviously any such representation is erroneous and will misstate, often very materially, the underlying facts. We feel that we should not permit the filing with us of income statements which readily permit, if they do not actually invite, such misuse. Even a "charge in lieu of taxes" may result in distorted overall statistics since it operates to reduce net income after taxes and so affects the ratio of actual taxes to net income. If the offsetting credit is netted against a surplus charge the distortion may be permanent.³⁵

(35) Under one variant of the practice no change is made in *final net income*. In the statements originally filed in the instant case, for example, part of the amount included as a charge among the operating expenses represented a \$609,949 reduction in income taxes due to the taking for tax purposes of accelerated amortization of emergency facilities at the rate of

The second and somewhat technical problem is the difficulty of the computation. It is usual in contemplating the tax consequences of a proposed transaction to treat it as an incremental or marginal item. Where tax rates are graduated, this results in associating the marginal income or expense with the highest tax bracket. It is questionable, whether such a principle is realistic when applied to the results of operations for a completed year. Net taxable income is a composite of all taxable income and all deductible items applicable to the period. The propriety of singling out any specific item as the item which is taxed in the highest tax bracket, is doubtful. Moreover, in applying the theory to losses and expenses it would appear that the existence of a reduction in taxes is due not only to the expense but is equally dependent on the existence of taxable income to offset the expense. It would appear possible that some part of the benefit from the "reduction" ought to be attributed to the existence of income.³⁶ Even if this point be waived, however, there has

20% a year while in the financial statements only normal depreciation was being accrued. See p. 11 *supra* and Exhibit A. In the original statements this \$609,949 was added back as the last item in the account. This internal in-and-out treatment appears to us to suffer from all of the difficulties we have discussed even though no change results in the amount of "net income." In our opinion, an overstatement of operating expenses is not corrected by "adding back" the amount of the overstatement at a later point in the income statement. Such treatment is in our view artificial and deceptive to all but the most experienced reader. While there may be some grounds for crediting such reductions in taxes to a special amortization reserve there is none for the equivocal practice here followed.

(36) We note the customary solution of a somewhat similar problem that arises when a group of companies files a consolidated tax return. In assigning to each constituent its fair share of the consolidated tax paid by the group it is usual to divide the actual tax among the companies who would have had to pay a tax on an individual basis. If one of the included companies operated at a loss, the consolidated tax is of course reduced, but *no* part of the "saving" is ordinarily paid over to the loss company by the other members of the group. Instead, only those *contributing* income to the consolidated return share directly in the benefit of the current reduction. This principle is incorporated in our Rule U-45 under the Public Utility Holding Company Act.

been no satisfactory analysis presented of the effect to be given to the carry-back, carry-forward provisions of the present income tax law. Without exploring all of the possible difficulties, one case may be cited. Suppose that a loss has been charged to surplus but is deductible for taxes. Suppose further that in accordance with the present proposal there is charged to income, as provision for taxes, the amount of \$200,000 although the actual tax amounts to only \$50,000. If in the next year the company suffers an operating loss of \$500,000, then in view of the carry-back provisions the reader of the two income statements would reasonably expect to find a carry-back refund of \$200,000—the amount shown as taxes in the first year. However, obviously no more than \$50,000 would actually be refundable. The question arises whether having overstated taxes in the first year it is not necessary, to be consistent, to overstate the refund in the second year. Finally, there are the permutations in the computation where a company pays taxes as a member of a consolidated group. In addition to the allocation of the actual tax paid among the several companies in the group, the proposed treatment raises the difficult question of whether the amount of the so-called “saving” is to be computed on the basis of a company’s individual status or on that of the consolidated group and, once this is decided, of whether to allocate this “saving” as between the several companies or attribute it solely to the company having the deduction—even though perhaps it itself contributed no taxable income!

The third difficulty is the propriety of singling out the income tax item for adjustment on the ground that it does not bear a “normal” relationship to the income reported. Particularly, under conditions like the present, many if not most of the income and expense items bear unusual relationships to each other. Under the influence of the war sales volumes are often very high. Maintenance may be very high due to continuous operation of the plant, or very low because of the inability to

obtain materials and labor, or very high because of the use of inexperienced labor and the inability to get new machinery, or very low because operations cannot be stopped long enough to make thorough-going maintenance possible. Selling costs may be very low because of the volume of war business or very high because of the use of advertising to keep restricted products in the public's mind. With many items of income and expense apt to be out of line, there appears to be little justification and a good deal of danger in singling out one item for adjustment.

III. MATERIAL FROM THE NATIONAL ASSOCIATION OF RAILROAD AND UTILITIES COMMISSIONERS

A. Excerpts from the 1943 Report of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners.

The subject of federal income and excess profits taxes has reached an importance in utility regulation requiring our constant consideration.

It has come to our attention that some utilities are including in the expense accounts for taxes, as a part of the accrual for federal income and excess profits taxes, amounts which they do not pay because of advantage gained by them from certain statutory deductions. We wish to call to your attention the fact that only the amount which it is anticipated will actually be payable for federal income and excess profits taxes can be included in the expenses of a public utility under the systems of accounts now in effect. The so-called "provision in lieu of taxes" may not be entered as an expense of the utility, nor may the amount of taxes which would have been payable, had certain statutory deductions not been available, be recorded as the tax expense.

In view of the importance of such taxes, the Committee has endeavored to prepare a report form that will present to the regulatory commissions such information as it must have for

an adequate understanding of the impact of federal income taxes. Our endeavor is to prepare a form that will not involve substantial additional work and still will provide the necessary information. A draft of such form was prepared by the conferee representing the Michigan Commission (Mr. C. R. Angell) and the said draft has been discussed at our meetings. Such discussion has brought out certain difficulties which it is hoped will soon be overcome. After the said report has been prepared to the satisfaction of the Committee, it will be circulated among all of the member commissions for their attention (pp. 255-56).

B. Excerpts from the 1945 Report of the Committee on Accounts and Statistics of the National Association of Railroad and Utilities Commissioners.

FEDERAL INCOME AND EXCESS PROFITS TAXES

In the 1943 and 1944 reports of the Committee, attention was directed to the problem of accounting for federal income and excess profits taxes by utility companies. Since the beginning of the period of high wartime taxes it has been the practice of many utilities to include in their tax accounts or in unprescribed accounts, such as "charges in lieu of taxes," amounts which do not represent taxes actually payable. Specifically, these amounts represent reductions in taxes otherwise payable except for extraordinary transactions such as a refunding of bonds, losses on sales of non-operating property, and of statutory provisions permitting amortization for tax purposes over a five-year period of certain facilities which qualify under the tax law as emergency facilities. The whole question, however, is complicated by a multiplicity of circumstances whereby there is non-conformity of taxable net income and financial net income reflected by a utility's books of account.

Extensive study also has been given to this question by the staff of the Securities and Exchange Commission, who furnished considerable material to aid the Committee in its consideration

of the question. At the May, 1945 meeting, the Committee culminated its study of the problem by concurrence in the following points:

(1) Income tax expense accounts should be charged with no more than the actual tax liability or a reasonable estimate thereof.

(2) A caption, "charges in lieu of taxes" or similar title should not be used.

(3) When charges to income measured by tax savings are made, they must be made to the proper account for the item to be charged off and must be adequately described.

(4) In assigning income taxes to departments and non-utility operations and transactions, the distribution should be to those departments, etc., which show net profits or income; it is not permissible to assign negative amounts to departments, etc., which show net losses.

An interpretation in accord with the foregoing is included with this report.

* * * * *

The Chairman of your Committee canvassed the views of the members and conferees and submitted the question for further discussion at the meeting in May, 1945. On the basis of this interchange of views, the Chairman was authorized to issue the following statement:

* * * For accounting purposes no charge can be permitted in operating expenses except for expenses actually incurred during the period for which the income statement is prepared. Provisions for future expenditures made during a current period must be made by means of an appropriation of net income.

With respect to the rate-making treatment, the following should be observed:

(a) The inclusion as an operating expense of any portion of tax savings, regardless of how they are described or of what they are to cover, is entirely unwarranted. (pp. 458-460)

IV. MATERIAL FROM THE TREASURY DEPARTMENT**A. I.T. 3637 [1944 Cumulative Bulletin 258]:**

Section 29.115-3: Earnings or profits.

INTERNAL REVENUE CODE.

For the purpose of determining the earnings and profits of each member of an affiliated group of corporations for the taxable year 1942 in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends, the consolidated income tax for that year should be apportioned between the members of the group in consonance with the ratio of each corporation's normal-tax net income to the consolidated normal-tax net income, and the consolidated excess profits tax should be apportioned between the members of the group on the basis of the adjusted excess profits net income.

Advice is requested as to the proper method of allocating consolidated income and excess profits taxes for 1942 in the case of an affiliated group of corporations for the purpose of determining the amount of the earnings and profits of each member of the group which is available for dividends.

Authority for the filing of consolidated income and excess profits tax returns for the year 1942 is found in section 141(a) of the Internal Revenue Code, as amended by section 159(a) of the Revenue Act of 1942. Section 141(b) of the Code, as amended, delegates to the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, the right to prescribe such regulations as he may deem necessary "in order that the tax liability of any affiliated group of corporations * * * and of each corporation in the group * * * may be returned, determined, computed, assessed, collected, and adjusted, in such manner as clearly to reflect the income- and excess-profits-tax liability * * * and in order to prevent avoidance of such tax liability." In so far as they are pertinent to the present inquiry,

Regulations 104, the consolidated income tax regulations, and Regulations 110, the consolidated excess profits tax regulations, are substantially identical.

Section 33.12(a) of Regulations 110 provides that the consolidated return shall be filed by the common parent corporation for the affiliated group. Section 33.12(b) prescribes that each subsidiary must prepare a certain statement consenting to Regulations 110 and authorizing the common parent corporation to make the consolidated return. Section 33.15(a) of Regulations 110 prescribes that "Except as provided in paragraphs (b) [liability of a corporation in bankruptcy or receivership] and (c) [liability of a subsidiary after withdrawal from the group], the common parent corporation and each subsidiary * * * shall be severally liable for the tax * * *." Section 33.16(a) of Regulations 110 reads in part as follows:

The common parent corporation shall be for all purposes [except where a subsidiary has withdrawn from the group and except where the common parent corporation is dissolved] * * * the sole agent, duly authorized to act in its own name in all matters relating to such tax, for each corporation * * * of the affiliated group. The corporations, other than the common parent, shall not have authority to act for or to represent themselves in any such matter. For example, all correspondence will be carried on directly with the common parent; notices of deficiencies will be mailed only to the common parent * * *; the common parent will file petitions and conduct proceedings before the Board of Tax Appeals [now The Tax Court of the United States] * * *; the common parent will file claims for refund or credit; refunds will be made directly to and in the name of the common parent * * *; and the common parent in its name will give waivers, give bonds, and execute closing agreements * * * and all other documents, and any waiver or bond so given * * * or any other document so executed, shall be considered as having also been given or executed by each such corporation.

For the year 1941, except in the cases of affiliated railroad corporations and Pan-American trade corporations, consolidated returns were not permitted for Federal income tax purposes, such returns being allowed only in connection with the excess profits tax. With respect to the year 1941, section 23(c)(1)(B) of the Internal Revenue Code, prior to its amendment by section 105(c)(1) of the Revenue Act of 1942, permitted the excess profits tax as a deduction in determining normal-tax net income. In this connection, Treasury Decision 5086 (C.B. 1941-2, 38, at page 46), amending Regulations 103 to conform to the Revenue Act of 1941, added section 19.23(c)-4, relating to deductibility of the excess profits tax imposed by Sub-chapter E of Chapter 2 of the Code. Paragraph (d) of section 19.23(c)-4 of Regulations 103, as so added, provides as follows:

The deduction allowable to a taxpayer which is a member of an affiliated group filing a consolidated excess-profits tax return is an amount which bears the same ratio to the excess-profits tax of the group as the normal-tax net income of the taxpayer, computed without a deduction for excess-profits tax, bears to the sum of the normal-tax net incomes of the several members of the group, computed without a deduction for excess-profits tax.

As shown above, in the case of a consolidated return, each member of the affiliated group is severally liable for both the income tax and the excess profits tax. It has also been shown that all tax matters are handled solely by the common parent corporation. That is for administrative reasons; each legal entity is still preserved. It was stated in Senate Report No. 960, Seventieth Congress, first session (C.B. 1939-1 (Part 2), 409, at pages 18, 419), in connection with the revenue bill of 1928:

The advisory committee of the Joint Committee on Internal Revenue Taxation, the members of which worked most of the summer in preparing suggestions for the simplification of the revenue laws and their administration, reached

the conclusion that, because of the difficulties encountered in administration, there should be a substitute for the consolidated returns provision. It should be emphasized that this conclusion was reached, not upon the ground that consolidated returns were unsound, that additional revenues would be received by the elimination of the consolidated returns provision, but solely upon the ground that the administration of the law would be simplified.

* * * * *

The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise.

* * * * *

* * * The committee believes it to be impracticable to attempt by legislation to prescribe the various detailed and complicated rules necessary to meet the many differing and complicated situations. Accordingly, it has found it necessary to delegate power to the Commissioner to prescribe regulations legislative in character covering them.

The Bureau is not concerned with arrangements made between affiliated companies as to the payment of the tax. The regulations look to payment being made by the parent corporation only, as such corporation is the only member of the group which can transact negotiations with respect to the tax. As a matter of fact, one of the affiliates may make all of the tax payment via the parent corporation, but if there is an overpayment, the refund is made to the parent corporation. (See section 33.16(a), Regulations 110, *supra*.)

In determining the amount of earnings and profits of each member of the affiliated group which is available for dividend purposes, it is necessary that each company's earnings be separately ascertained. One of the factors in determining earnings and profits for any taxable year is the amount of income and excess profits taxes due for such year. In a consolidated return

case, the consolidated taxes should be allocated, as set forth below, to each member of the affiliated group. The fact that the parent corporation pays all of the tax should not militate against such an allocation. As heretofore indicated, such tax is paid by the parent as agent for the subsidiaries.

Accordingly, it is held that for the purpose of determining the earnings and profits of each member of an affiliated group of corporations for the taxable year 1942 in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends, the consolidated income tax for that year should be apportioned between the members of the group in consonance with the ratio of each corporation's normal-tax net income to the consolidated normal-tax net income. The consolidated excess profits tax should be apportioned between the members of the group on the basis of the adjusted excess profits net income.

B. I.T. 3692 [1944 Cumulative Bulletin 261]:

Section 29.115-3; Earnings or profits.

INTERNAL REVENUE CODE.

Method of determining the earnings and profits of each member of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for 1942 and subsequent taxable years, in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends.

I.T. 3637 (page 258, this Bulletin) amplified.

Request is made for an amplification of I.T. 3637 (page 258, this Bulletin), relating to the method of determining the earnings and profits of each member of an affiliated group of corporations filing consolidated Federal income and excess profits tax returns for the taxable year 1942 in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends.

For the purpose of determining the earnings and profits of each member of an affiliated group of corporations for the taxable year 1942 and subsequent years in order to ascertain the amount of earnings and profits of each member of the group which is available for dividends, the consolidated income tax (line 41, page 1, Form 1120) should be apportioned between the members of the group in accordance with the ratio of that portion of the consolidated normal-tax net income attributable to each member of the affiliated group to the consolidated normal-tax net income (line 40, page 1, Form 1120), leaving out of consideration any member of the group having no net income. The consolidated excess profits tax (line 18(c), page 1, Form 1121) should be apportioned between the members of the group in accordance with the ratio of that portion of the consolidated adjusted excess profits net income attributable to each member of the affiliated group to the consolidated adjusted excess profits net income (line 8, page 1, Form 1121), leaving out of consideration any member of the group having no net income. The taxes thus determined should be (a) decreased by the amount of the consolidated credit for debt retirement (line 21, page 1, Form 1121) attributable to each company; (b) increased or decreased, as the case may be, by the amount of any section 734 adjustment (line 23, page 1, Form 1121) attributable to each company; and (c) decreased by the amount of the consolidated credit for foreign taxes attributable to each company (line 19, page 1, Form 1121). In the event that the income taxes paid to a foreign country or United States possession are in excess of the amounts allowed as credits, the excess should be taken into consideration in arriving at the earnings available for dividends.

C. Excerpt from T.D. 5086, Amendments to Regulations 103 [1941-2 Cumulative Bulletin 46]:

PAR. 21. There is inserted immediately after section 19.23(c)-3 the following:

SEC. 19.23(c)-4. *Excess-profits tax under Subchapter E of Chapter 2 of the Internal Revenue Code.*—The deductibility of the excess-profits tax imposed by Subchapter E of Chapter 2 of the Internal Revenue Code is subject to the following special rules:

* * * * *

(d) The deduction allowable to a taxpayer which is a member of an affiliated group filing a consolidated excess-profits tax return is an amount which bears the same ratio to the excess-profits tax of the group as the normal-tax net income of the taxpayer, computed without a deduction for excess-profits tax, bears to the sum of the normal-tax net incomes of the several members of the group, computed without a deduction for excess-profits tax.

V. Tabulation of Congressional Material Relating to Consolidated Tax Returns.

Senate Finance Committee Reports on the Revenue Bills of 1918, 1921, 1928, 1932 and 1934.

House Ways and Means Committee Reports on the Revenue Bills of 1921, 1928 and 1934.

Memorandum of the Senate Finance Committee on the 1918 Revenue Act.

Report of the Joint Committee on Internal Revenue Taxation (1926).

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Preliminary Report of Sub-Committee of the House Ways and Means Committee on Prevention of Tax Avoidance (1933).

Hearings before the House Ways and Means Committee on the Revenue Revision of 1934.

Hearings before the Senate Finance Committee on the Revenue Act of 1934.

Joint Hearings of the House Ways and Means Committee and the Senate Finance Committee on Excess Profits Taxation (1940).

Hearings before the Senate Finance Committee on the Revenue Act of 1940.

Hearings before the House Ways and Means Committee on Revenue Revision of 1942.

No. 12,506

IN THE

United States

Court of Appeals

For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION
and ALEXIS I. duP. BAYARD, RECEIVER,
Plaintiffs and Appellants,
and

MEREDITH H. METZGER, HENRY OFFERMAN and
J. S. FARLEE & CO., INC., a corporation,
Interveners and Appellants,
vs.

THE WESTERN PACIFIC RAILROAD COMPANY, et al.,
Defendants and Appellees.

Reply Brief of Appellants

The Western Pacific Railroad Corporation
and Alexis I. duP. Bayard, Receiver

HERMAN PHLEGER,
MAURICE E. HARRISON,
MOSES LASKY,
BROBECK, PHLEGER & HARRISON,
111 Sutter Street, San Francisco 4, Calif.

FRANK C. NICODEMUS, JR.,
44 Wall Street, New York 5, N. Y.

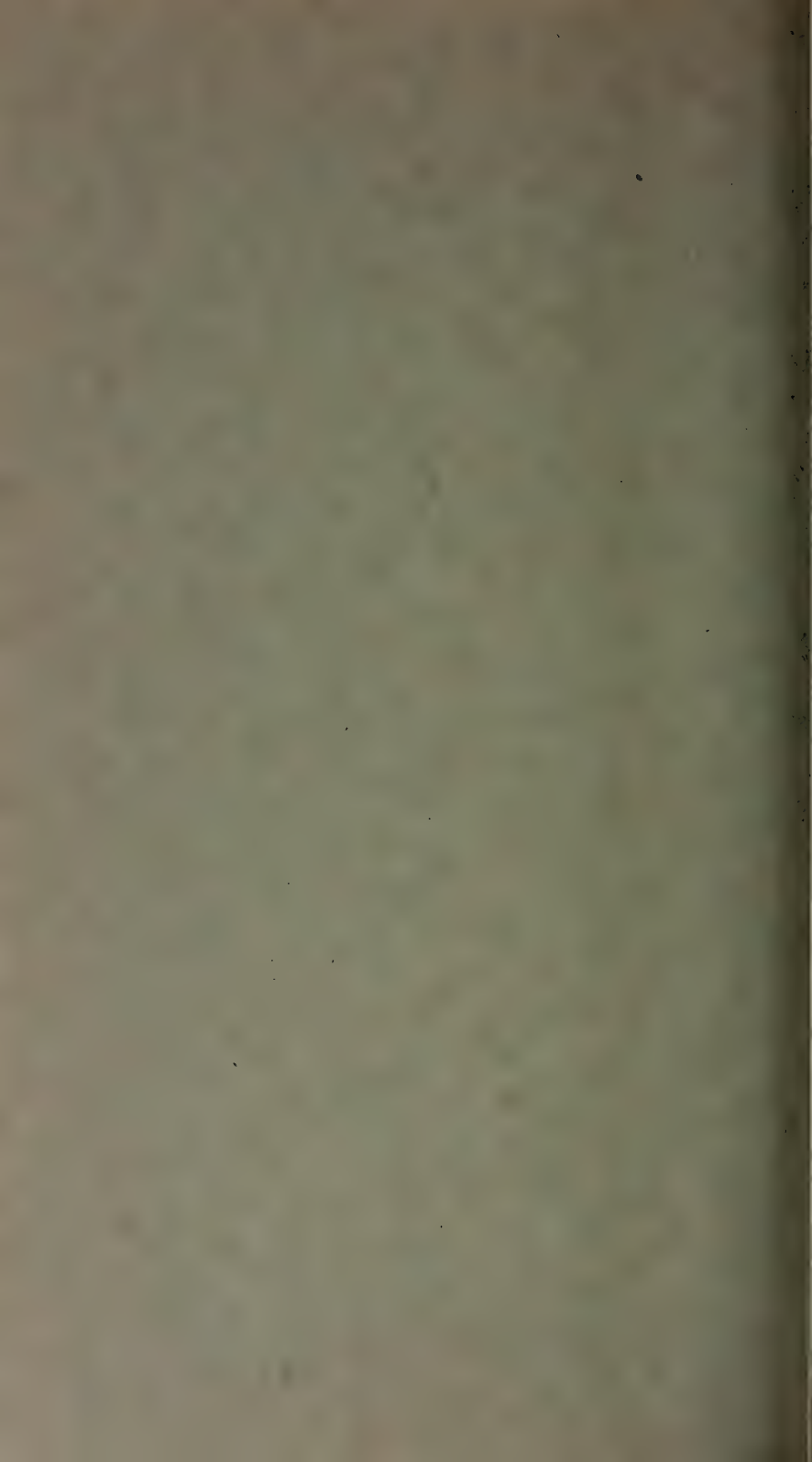
A. PERRY OSBORN,
20 Exchange Place, New York 5, N. Y.

NORRIS DARRELL,
48 Wall Street, New York 5, N. Y.

MAHLON DICKERSON,
120 Broadway, New York 5, N. Y.

LEROY R. GOODRICH,
Bank of America Building,
Oakland 12, Calif.

*Attorneys for Plaintiffs
and Appellants*



SUBJECT INDEX

	Page
Discussion	5
I. Defendant's Arguments on the Merits Are Permeated by Certain Fallacies and Erroneous Assumptions.....	5
A. The Fallacious Persistence in Refusing to Recognize the Unique Fact of This Case—the Severance of the Economic Unity—and in Referring to Alleged "Past Practice" and Alleged "General Practice".....	5
Practice of Other Companies.....	7
Answer to Defendant's Discussion of the Severance of the Economic Unity.....	8
Defendant's Assertions About "All the Precedents".....	10
B. The Fallacious Notion That Tax Savings Cannot Be the Subject of Equitable Cognizance or of an Accounting....	14
C. The Refusal to Recognize That Defendant Assumed a Fiduciary Relationship to the Plaintiff and Unilaterally Appropriated Plaintiff's Rights, and That the Benefits Were Not Conferred by Plaintiff on Defendant Either Officially or as a Gratuity or by Any Voluntary Act but Were Taken.....	16
D. The Fallacy That Plaintiff Was Under a Duty to Make a Gift of Its Rights to Defendant.....	22
II. There Is No Merit to Defendant's Contention That Plaintiff's Claims, Though Valid, Should Be Denied Because of the Reorganization Proceedings.....	25
A. Plaintiff's Claim Is Not Remotely in Derogation of the Policy of Section 77 of the Bankruptcy Act or the Purpose of Defendant's Reorganization.....	26
B. Plaintiff's Claims Arose After the Revesting of the Railroad Properties in Defendant.....	26

	Page
C. If Any Part of Plaintiff's Claims Arose Before Revesting, the Reorganization Court Required Them to Be Assumed, and They Were Assumed, by Defendant; the Court Made No Order Barring the Claims.....	29
Final Order.....	32
D. Plaintiff's Claims Did Not Have to Be Approved by the Bankruptcy Court.....	32
Absence of Notice to Present Claims.....	38
Answer to Defendant's Contention About Contingent Claims	40
E. Reply to Defendant's Argument That There Can Be No Obligation to Plaintiff Because the Trustees Had No Authority to Incur It.....	41
F. The Fact That Defendant Was in a Fiduciary Relation to Plaintiff Suffices to Prevent Destruction of Plaintiff's Claims	44
Conclusion	45

INDEX OF AUTHORITIES

TABLE OF CASES

Pages

Alphonzo E. Bell Corp. v. Bell View Oil Syndicate, 46 C.A.2d 684, 116 P.2d 786.....	43n
American Service Co. v. Henderson, 120 F.2d 525.....	41n
Anderson v. Calaveras Cent. Min. Co., 13 C.A.2d 338, 57 P.2d 560	46n
Anderson v. Chicago, R. I. & P. Ry. Co., 175 N.W. 583, 189 Iowa 739	36n
Austin v. Harry E. Jones, 30 C.A.2d 362, 86 P.2d 379.....	46n
Bankers Trust Company v. Florida East Coast Car Ferry Co., 92 F.2d 450.....	10
Bartlett v. Cicero Light, Heat & Power Co., 52 N.E. 339, 177 Ill. 68	36
Benton v. Callaway, 165 F.2d 877.....	24n
Burnes v. Missouri National Bank, 7 F.2d 978.....	42n
Callaway v. Benton, 336 U.S. 132.....	24n, 34n
Central Trust Co. of New York v. Ohio Central R. Co., 23 Fed. 306	43
Chicago Deposit Vault Company v. McNulta, 153 U.S. 554.....	41
City Bank Farmers Trust v. Irving, 299 U.S. 433.....	40n
Commercial Nat. Bank in Shreveport v. Connolly, 176 F.2d 1004 (5 Cir.).....	14
Coper v. Central Alloy Steel Corporation, 183 N.E. 439, 43 Ohio App. 455.....	14n
Elysee v. Erie R. Co., 175 F.2d 58.....	37
Forwards v. Lee's Admr., 96 S.W.2d 1028, 265 Ky. 418.....	18
Forwards v. Sims, 24 S.W.2d 619.....	18n
Estate of John B. Lewis, 10 T.C. 1080.....	10n
Hust v. Munson SS Lines, 299 U.S. 77.....	41n
Hench v. Shoemaker, 14 Wall. 314.....	25n
Greek Catholic Congregation v. Plummer, 32 A.2d 299 (Pa.).....	17n

	Page
Guaranty Trust Company v. Henwood, 86 F.2d 347.....	41
Gutensohn v. Kansas City Southern Railway Co., 140 F.2d 950 (8 Cir.)	4
Haines v. Buckeye Wheel Co., 224 Fed. 289 (6 Cir.).....	4
Hanlon v. Smith, 175 Fed. 192.....	3
Hippodrome Building Co. v. Irving Trust Co., 91 F.2d 753.....	40
Hopkins v. Detrick, 97 A.C.A. 55.....	14
Houck v. Hubbard Milling Co., 167 N.W. 1038 (Minn.).....	17
In re Central R. Co. of New Jersey, 136 F.2d 633 (3 Cir.), cer. den. 320 U.S. 805.....	3
In re Colorado & S. R. Co., 84 F. Supp. 134.....	26
In re Erie Lumber Co., 150 Fed. 817.....	4
In re Glenn-Colusa Irrigation District, 62 F. Supp. 651 (N.D. Cal.)	3
In re Hunter, 151 Fed. 904.....	4
In re Missouri Pacific Railroad Company, No. 6935, U.S.D.C. E.D. Mo.	15
In re Southwestern Ry. Co., 17 F. Supp. 68, aff'd 88 F.2d 163.....	3
In the Matter of Consolidated Gas & Electric Company, 13 S.E.C. Decisions and Reports 649.....	1
In the Matter of Consolidated Electric and Gas Company, 15 S.E.C. Decisions and Reports 161.....	1
Investment Building v. Finance Co. of America, 105 F.2d 345 (3 Cir.)	3
Kelley v. Caplice, 23 Kan. 474.....	25
Kentucky Cave Case, 96 S.W.2d 1028, 265 Ky. 418.....	1
Lain v. Rennert, 32 N.E.2d 375 (Ill. App.).....	25
Lowden v. State Corp. Comm'r, 76 P.2d 1139, 42 N.M. 254.....	35
Maguire v. Hibernia Savings & Loan Society, 23 Cal.2d 719, 146 P.2d 673.....	41, 45
McArthur v. Blaisdell, 159 Cal. 604, 115 Pac. 52.....	46
McColgan v. Maier Brewing Co., 134 F.2d 385 (9 Cir.).....	3
Moss v. Moss, 20 Cal.2d 640, 128 P.2d 526.....	46

	Pages
North American Car Corporation v. Peerless W. & V. Mach. Corporation, 143 F.2d 938 (2 Cir.).....	39n
Northern Finance Corporation v. Byrnes, 5 F.2d 11.....	42n
Peavy-Byrnes Lumber Co., Inc. v. Long-Bell Lumber Co., 55 F. Supp. 654.....	38
People v. Canadian Fur Trappers' Corp., 161 N.E. 455, 458, 248 N.Y. 159	8n
Peese v. Beacon Hotel Corporation, 149 F.2d 610.....	34n
Poos v. Hosmer, 44 N.E.2d 641 (Mass.).....	17n
St. Louis San Francisco Railway Co. Reorganization, 257 I.C.C. 399, 410	13n
Seaboard Air Line R. Co. v. Savannah Union Station Co., 181 F.2d 267 (5 Cir.).....	27
Skulow v. 11th & F. St. Valet, Inc., 162 F.2d 19 (D.C. Cir.).....	25n
Shepherd v. Turner, 129 Cal. 530, 532, 62 Pac. 106.....	8n
Sherman v. S. K. D. Oil Company, 185 Cal. 534, 197 Pac. 799....	46n
Sherwood & Sherwood v. Gill & Lutz, 36 Cal. App. 707, 173 Pac. 171	45n, 46n
Silverport Bank Cases, 28 F. Supp. 927; 144 F.2d 191; 72 F. Supp. 961; 176 F.2d 1004.....	14
Straube v. Bowling Green Gas Co., 227 S.W.2d 666 (Mo.).....	17n
Swart v. Dickinson, 235 S.W. 446; 290 Mo. 516.....	36n
Texas & Pacific Railway Company v. Bloom, 164 U.S. 636.....	36, 37
Texas & Pacific Railway Company v. Johnson, 151 U.S. 81.....	33, 36, 37
Thompson v. State of Louisiana, 98 F.2d 108 (8 Cir.).....	35
Thompson v. Texas Mexican R. Co., 328 U.S. 134.....	42
Tuncale v. Universal Pictures, Inc., 76 F. Supp. 465.....	18, 25n
Vanderbilt University v. Williams, 280 S.W. 689 (Tenn.).....	17n
Wheeling Valley Coal Corporation v. Brady, 159 F.2d 155 (4 Cir.)	45
Whiting v. Hudson Trust Co., 138 N.E. 33, 23 N.Y. 394.....	43

STATUTES AND REGULATIONS		Page
Bankruptcy Act:		
Section 77.....	26, 34, 35, 36, 38, 41, 4	4
Section 77, subd. (a).....		35
Section 77, subd. (c) (2).....		35
Section 77, subd. (c) (8).....		3
Section 77, subd. (f).....		3
Section 77B.....		37, 4
Chapter X.....		37, 4
Chapter XV.....		26
California Civil Code:		
Section 3521.....		37
California Code of Civil Procedure:		
Section 337 (1).....		45
Section 343.....		46
Internal Revenue Code:		
Section 52.....		4
Section 141 (d).....		
McLaughlin Act (56 Stats. 787):		
Sections 722 and 738.....		26
Public Utility Holding Company Act of 1935.....		
		1
Securities and Exchange Commission Rule U-45.....		
		1
United States Code:		
Title 11, Section 205 (a)		35
Section 205 (c) (2)		35
Section 205 (f)		34

TEXTS

American Jurisprudence:	
Volume 45, Sec. 345, p. 276.....	36
1 Clark on Receivers (2d ed.):	
p. 527.....	4
p. 677, Section 494.....	3
p. 677, Section 495.....	36
p. 1008.....	4

	Pages
Collier on Bankruptcy (14th ed.):	
Vol. 5, p. 467.....	35n
Vol. 5, p. 468.....	35n
Vol. 5, p. 493.....	35
Vol. 6, Section 11.18, pp. 3922-24.....	37
Fletcher's Cyclopedia of Corporations (Perm. Ed.), Section 3579, p. 721.....	43n
Glenn on Liquidation:	
Section 165, pp. 273, 274.....	36n
Section 165, p. 429.....	45
Pomeroy, Equity Jurisprudence (5th ed.):	
Section 186(a), pp. 267-8.....	46n
Restatement of Restitution:	
Section 153, p. 607.....	17
Section 155.....	18
Restatement of Trusts:	
Section 269.....	42
Section 269, Comment a, Illus. 1.....	42
Scott on Trusts:	
Vol. 2, Sections 269 to 269.2.....	42
Vol. 2, Section 269.3.....	18, 43
Senate Report 960, 70th Congr., 1st Sess., p. 8.....	9n
S.E.C. Release No. 53, Accounting Series.....	11
Williston on Contracts (Rev. ed.):	
Vol. 5, Section 1606.....	25n

IN THE
United States
Court of Appeals
For the Ninth Circuit

THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. duP. BAYARD, Receiver,
Plaintiffs and Appellants,
and

MEREDITH H. METZGER, HENRY OFFERMAN
and J. S. FARLEE & CO., INC., a corporation,
Interveners and Appellants,
vs.

THE WESTERN PACIFIC RAILROAD COMPANY,
et al.,
Defendants and Appellees.

Reply Brief of Appellants
The Western Pacific Railroad Corporation
and Alexis I. duP. Bayard, Receiver

An examination of defendant's brief shows the following propositions proved or admitted:

Appellee The Western Pacific Railroad Company will be referred to as defendant, and appellant The Western Pacific Railroad Corporation as plaintiff. The symbol "O.B." will be used to refer to that appellant's opening brief; "D.Br." refers to appellee's brief. References to the record and exhibits will be made in the manner described in the footnote on O.B. 2.

1. The defendant paid its \$17,000,000 tax liability by the use of plaintiff's loss; otherwise the \$17,000,000 would have been paid by defendant into the United States Treasury.*

2. The plan of using plaintiff's rights was conceived and executed by defendant without any consideration whatever of plaintiff, at a time when plaintiff's officers were employees of defendant and acting at its direction.

3. At the time, plaintiff had no economic interest in defendant and owed it no duty. On the contrary, defendant occupied a fiduciary relationship toward plaintiff.

On plain principles of law it is submitted that plaintiff is therefore entitled to judgment.

Defendant's brief is mainly devoted to three arguments:

1. Defendant contends that plaintiff cannot recover because what was done was in accord with general business practice and the previous conduct of these parties.

The short answer to this is that it is not so. When the returns were filed plaintiff was a complete economic stranger to defendant and had no pecuniary interest in it. What was done at an earlier time when plaintiff owned all defendant's stock and benefited from any tax or other advantage accruing to defendant is completely irrelevant here. As the court below held, in excluding defendant's proffered evidence of general business practice, there is not only no general practice in the filing of consolidated returns by companies where one has no economic interest in the other but this case is *sui generis*.

2. Defendant contends that a judgment for plaintiff would circumvent the reorganization plan and give plaintiff a share of

*Defendant's brief, admitting savings from use of plaintiff's rights asserts that they are some unspecified amount less than \$17,000,000 because it would have been possible for defendant "to file separate returns and take advantage of deductions unavailable under consolidated returns" (D.B. 26, 65, 66).

The same contention was tried, briefed and argued below, and the trial court found against defendant. It found specifically (267) that the tax benefit which defendant obtained by use of plaintiff's loss was \$17,201,731.

defendant's earnings, after the Supreme Court had held that its interest was valueless.

The answer to this is that the reorganization plan contemplated that defendant would pay its taxes in full, and it would have done so if it had not appropriated plaintiff's loss and used it to pay its taxes. Plaintiff does not seek to share in defendant's earnings, or to share in its equity. It asks that defendant account for the benefit it received through the use of plaintiff's property and rights—the discharge of its \$17,000,000 tax liability (see O. B. 93).

Its attempt to defeat plaintiff's claim on the merits failing, defendant argues that even though it may owe plaintiff \$17,000,000, it need not pay because the claim was not presented in the bankruptcy court and is barred by its final decree.

The answer to this is that pursuant to the Reorganization Plan and the court's decree defendant assumed and agreed to discharge all liabilities of the trustees, which would include this liability if it arose during bankruptcy; but in fact the liability arose and the obligation to account became fixed long afterward. The final decree was not intended to, did not and could not bar plaintiff's claim.

These are defendant's chief points. We cannot refrain from noting that in defendant's brief there is an entire absence of a recognition that throughout this transaction defendant was a fiduciary for plaintiff and owed it the duty of acting in the highest good faith and with a scrupulous regard for the rights of its stockholders who had lost their \$75,000,000 investment. Defendant's brief shows a like disregard, or perhaps a studied avoidance, of the fact that during this time plaintiff and defendant were entire economic strangers, without financial interest one in the other. These attitudes explain perhaps, though they do not excuse, the defendant's callous disregard of plaintiff's rights. Defendant may

have believed, if it gave any thought to plaintiff at all, which we doubt, that a corporation in ruin, with its principal officer in the office of the defendant's attorney and in the defendant's pay, had no rights.

It would indeed be a perversion of equity and the Revenue Laws if the defendant who owed \$17,000,000 in taxes, and paid those taxes by using plaintiff's property and rights, should retain the unjust enrichment thus resulting. There has been much talk of "tax savings" here. In reality the defendant simply paid its taxes with the plaintiff's property. The government permitted taxes to be paid in this way, because the policy of the law intended the benefit thereof to ameliorate the loss of the affiliate, whose loss paid the tax. Defendant took something having a use value of \$17,000,000 away from the plaintiff and paid its own taxes with it. Justice is not impotent to grant relief, simply because the factual situation is unique and the amount involved large.

Defendant argues that "merchandising tax advantages" is against the policy of the law (D. Br. 64). If the use of plaintiff's rights to give defendant a tax advantage was rightful as respects the government—and defendant and plaintiff agree that it was—it is pharasaical to say that defendant is precluded from accounting for the advantage. And, if its use as respects the government were wrongful, it is a strange argument to contend that there is a public policy which requires a wrongdoer to keep its pockets lined (cf. O. B. 82-87). As we have shown (O. B. 39-50), only an accounting to plaintiff can remove the case from the condemnation of "merchandising tax advantages" and of utilizing consolidated returns for merely tax reducing purposes.

The chief characteristic of defendant's brief is that a number of legal fallacies and erroneous assumptions run throughout all its arguments. If these are extracted, the arguments crumble.

This Reply Brief is divided into: (1) An analysis of defendant's principal assertions on the merits, and (2) an answer to the technical defense that even if plaintiff "had a valid claim," it is barred by the Reorganization decree (D. Br. 68-83).

DISCUSSION

I.

DEFENDANT'S ARGUMENTS ON THE MERITS ARE PERMEATED BY CERTAIN FALLACIES AND ERRONEOUS ASSUMPTIONS**A. The Fallacious Persistence in Refusing to Recognize the Unique Fact of This Case—the Severance of the Economic Unity—and in Referring to Alleged "Past Practice" and Alleged "General Practice."**

Defendant asserts that it was the uniform "practice" of plaintiff and defendant to file consolidated returns and for the affiliate with a loss to receive nothing for it. Almost every contention that it makes comes back to this as its keystone.*

Yet at the outset it insists that the "pre-reorganization The Western Pacific Railroad Company" and the "reorganized The Western Pacific Railroad Company" are two different entities (D. Br. 2). Technically, the company is the same corporation, before and after reorganization, for the assets taken over by the trustees in 1935 were revested in the same corporate entity in December 1944.

But the capital stock was owned by different people after the reorganization than before. While this difference did not change the corporate entity, it cuts the ground from under defendant's arguments about past practice.

Prior to the reorganization plaintiff was defendant's owner. Hereafter defendant was a total stranger to the plaintiff, with new owners. And if defendant is not now compelled to account, these new owners will be the people who will be enriched by use of plaintiff's rights.

The Supreme Court's decision of March 15, 1943, and the order of October 11, 1943, confirming the Plan of Reorganization completely changed the relationship of the parties to each other. Until these occurrences the plaintiff and the defendant were an economic unity—a single family. So long as that unity continued,

*E.g., D.Br. 7, 18, 22, 30, 35, 38, 42, 52, 59, 65, 66, 67.

a decision to file consolidated returns was that of the parent; the profits, gains or benefits of the subsidiary, or its losses or detriments, flowed to the plaintiff's stockholders sooner or later, since it was the owner of the economic unity. It was a matter of indifference where the benefits or detriments happened to fall in the first instance or whether a subsidiary accounted to the parent for any tax savings resulting from the use of the parent's tax credits or, instead, those savings inured to the parent through its ownership.

The Supreme Court's decision and the order of confirmation severed the economic unity. After March 15, 1943, the defendant was no longer in any real sense the same party which had filed consolidated returns with the plaintiff in the years prior to 1942. Consequently, "past practice" is irrelevant. The trial court so held.

As it said (1377):

"I just don't see the point of what any affiliated company has done in the past as a matter of practice in these returns because they have all been decisions that have been made by the parent company, and when the parent company decided that it was proper to file affiliated returns, it filed them, and of course there is no dispute about the fact that the parent company filed the affiliated returns whenever it decided it was proper to do so. What we have in this case is not concerned with that."

"Past practice" is irrelevant, not only because the relationship between the parties to whom that practice applied had vitally changed, but because there was not in fact any practice whatever in prior years that has any relation to the facts of this case. The situation here was unique. The loss used to produce the tax savings was the loss of the parent's stock in the subsidiary. Yet (1) it was an amendment to the tax law in October, 1942, that made the utilization of this kind of loss possible at all (see O. B. 43-44); and (2) use of that loss to eliminate the former subsidiary's tax was "paradoxical" (see O. B. 17). Although the loss was the result of severing the economic unity, the subsidiary was enabled to use the loss by reason of the tax concept of consolidated returns which has its rationale in the existence of that unity.

Furthermore, the only respect in which past practice could conceivably be relevant would be in the construction of a contract entered into by parties with each other. But in this case there was no such contract. Defendant simply took over and carried through the tax matters without agreement. Defendant asserts (D. Br. 66) that "one who participates in an established course of conduct over a long period may not, after the event, attach new consequences to the customary activity," and it cites cases where the evidence showed a contract defining the rights of the parties. Here what was done prior to the critical event of the severance of the economic unity cannot evidence a contractual consent to what was hereafter done in circumstances utterly different, involving a kind of loss the like of which had never before been known and which never before could have been the subject of tax deductions.*

PRACTICE OF OTHER COMPANIES.

Defendant also makes numerous statements about what it calls the general practice of the business community" (e. g., D. Br. 2). There is no evidence of any such practice. As defendant admits (D. Br. 53), the elaborate evidence offered by it was excluded by the court as irrelevant (1377-1383, 1394).

* Actually, the evidence as to past practice is quite empty. In the 11 years, 1930-1941, inclusive, there was not a single year in which the *parent's* tax credits were utilized by the *subsidiary* defendant. In that period no taxes at all were paid by the affiliated group (1263). In the years 1936-1941, inclusive, neither plaintiff nor defendant had taxable income, both had losses, and on a separate return basis neither would have had to pay a tax (2040 D 46; 2041 D 47). What happened in those years could therefore have no bearing on the only practice that could conceivably be relevant—whether the defendant, a subsidiary, had in the past accounted to the parent for tax savings resulting from use of the parent's credit.

In the years 1930-1935, while the parent had some net income, the defendant had losses, so that the subsidiary was not saved from taxes by the parent's tax credits (2040, 2041).

The years prior to 1930 are too remote. Prior to 1922 consolidated returns were mandatory under the tax laws (see O.B. 39), so a wholly different question would have been involved. In the next 7 years, 1923-1929, in only two instances (1925 and 1928) did the parent's loss result in tax savings to defendant subsidiary and then for only slightly more than 20,000 (2041), of which plaintiff received the benefit as owner of the enterprise.

An appellee may not support a judgment by evidence excluded below.* The proffered evidence ignored the vital and unique fact in this case, the severance of the economic unity, which distinguishes this case from all others. As the trial court said in excluding the evidence (1379):

"The question would never arise under the general business practice, because I do not think you would ever have any litigation. Absent the kind of situation that you have here between companies that were free agents to agree with one another to file this type of return. Here you have a situation where a third party, a new party, is getting the benefit of this tax situation. * * * the problem that is presented by it is entirely different from what might happen in the ordinary business relationship of parent and subsidiary companies, where you have not the interposition of reorganization proceedings and all that they entail."

This case involves no general question of how losses should be shared between affiliated corporations when consolidated returns are filed. It involves the loss to the parent of its ownership in its subsidiary, thus bringing about a severance of the economic unit then and there so that the parent can no longer achieve the benefits of the tax savings through its continued ownership. (See question, O. B. 29.)

Defendant cites no instance where such a loss was ever available to the former subsidiary to avoid what would otherwise be its tax obligations. This fact disposes of the argument that a judgment for plaintiffs will create uncertainties in the law (D. Br. 64).

ANSWER TO DEFENDANT'S DISCUSSION OF THE SEVERANCE OF THE ECONOMIC UNITY.

Defendant's answer to the unique fact of the case is no more than a denial that there was a severance of the economic unity and a mere assertion that the fact is without significance (D. Br. 60-64).

**Shepherd v. Turner*, 129 Cal. 530, 62 Pac. 106; *People v. Canadian Fur Trapper's Corp.*, 248 N.Y. 159, 161 N.E. 455, 458.

Defendant contends that the confirmation of the Plan "severed nothing" (D. Br. 60) because the "affiliation" continued to April 1944. But that continued "affiliation" was technical only. Had not the worthless stock been surrendered the assets would have been vested in a new corporation (see O. B. 25, 26).

Defendant argues that "economic unity" in matters of consolidated returns is a false factor, because a subsidiary may have bonds or non-voting preferred stock outstanding. This flies in the face of the principle upon which consolidated returns are based, namely, that a single business enterprise, though conducted by separate corporations, shall be taxed as a unit. For consolidated returns to be available, the parent must own not only 95% of the voting stock but 95% of all non-voting stock other than preferred stock limited as to dividends. (Internal Revenue Code, Sec. 41(d).) In short, the parent must own what for practical purposes is the entire equity.*

Holdings by others of interests which do not share fully in the equity do not affect the economic unity. If, as defendant argues, tax savings go to pay bondholders or preferred stockholders, then payment of these overriding obligations *pro tanto* lifts the load depressing the equity and correspondingly increases its value to the benefit of the parent. The economic unity continuing, precise mathematical admeasurement of the benefit to the parent is of

*At page 42 of our Opening Brief we quoted briefly from a Senate Report. Quoting more extensively, the passage reads:

"Much of the misapprehension about consolidated returns will be removed when it is realized that it is only when the corporations are really but one corporation that the permission to file consolidated returns is given, and that no ultimate advantage under the tax laws really results. The present law permits the filing of consolidated returns only where one corporation owning at least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts." (S.R. 960, 70th Cong., 1st Sess., p. 8)

Defendant itself quotes this passage from a Treasury Regulation:

"The permission to file consolidated returns by affiliated corporations merely recognizes the business entity as distinguished from the legal corporate entity of the business enterprise." (D.Br., Appendix, p. 20)

no consequence. On the other hand, if the overriding load is so great that in fact there is no equity, e. g., if the subsidiary is insolvent, the economic unity has in effect been severed. Such, for example, was the situation presented in *Bankers Trust Company v. Florida East Coast Car Ferry Co.*, 92 F.2d 450 (discussed O. B. 48).*

DEFENDANT'S ASSERTIONS ABOUT "ALL THE PRECEDENTS."

Defendant's fallacy about alleged "general practice" vitiates its assertions about "all the precedents" as "guides for the proper settlement of intra-group liabilities" (e. g., D. Br. 22, 50, 52-58).

In this category fall its references to an investigation by the Federal Trade Commission in the late 1920's of utility holding companies, the enactment 8 years later of the Public Utility Holding Company Act of 1935, and Rule U-45 issued thereunder by the Securities and Exchange Commission.†

There is a significant lesson to be drawn from the action of the S. E. C. under its Rule U-45, but it is the reverse of what defendant contends. When an affiliate's tax savings resulting from the use of another affiliate's loss could not or might not reach the

*Defendant glides from discussion of a case where a parent's losses are used to benefit a subsidiary to the quite different case where the latter's losses are used to benefit a parent. But, the economic unity continuing the subsidiary has no interests apart from the parent. As said in *Estate of John B. Lewis*, 10 T.C. 1080 (1948):

"To say that a corporation, as such, can have motives and purposes apart from its stockholders, the collective group of individuals who own it, is to indulge in metaphysical reasoning * * * and to say that what is advantageous to the stockholders * * * is of no advantage to the corporation is utterly unrealistic."

If facts should ever arise whereby, despite economic unity, the use of a subsidiary's losses to benefit the parent should encroach on the rights of the subsidiary's bondholders or minority preferred stockholders, equity is competent to protect them. Minority interests have frequently been protected in the past, in a variety of situations.

†The Public Utility Holding Company Act of 1935 is not relevant. It pertains to gas and electric companies and contains nothing about consolidated returns but conferred power on the S.E.C. to regulate intercompany transactions. Under it the S.E.C. issued Rule U-45, which prohibits certain intercorporate donations unless made pursuant to prior notice to the Commission, but exempts certain tax transactions.

party suffering the loss through ordinary channels, as by way of dividends or increase of its equity—the S. E. C. has considered it equitable that the benefit of the tax savings be passed directly to the party who suffered the loss.

The S. E. C. cases discussed in our Opening Brief (at pp. 44-47) do show. Defendant seeks to distinguish one of the two cases, *In the Matter of Consolidated Gas & Electric Company*, 13 S. E. C. 549, by asserting that the affiliate (Islands) whose loss was used would thereby be subjected to a future tax, and that the group members merely proposed an arrangement to put it in the same position as if it had filed a separate return (D. Br. 54).

But this is not the fact, for the S. E. C. found that the amount of the future tax would “be considerably less than the tax savings to be presently effected” (13 S. E. C. at 653). The proposal was that the *whole* of the tax saving should be paid to Islands, and it was this proposal that the S. E. C. approved (13 S. E. C. at 652).

Of the other S. E. C. decision (*In the Matter of Consolidated Electric & Gas Company*, 15 S. E. C. 161) defendant says (D. Br. 55):

“Since the parent who received the payment was entitled to the money in any event, the Commission saw this case only as an accounting problem and agreed to the proposed arrangement for that reason.”

This is nothing less than a concession that tax savings resulting from use of a parent's loss belong to the parent.

The two S. E. C. cases involved the same group, and as shown in one of them, “the announced program of Consolidated is one for the liquidation of the Consolidated system” (13 S. E. C., p. 553, footnote). Since the economic unity was to be severed, it was equitable that the tax savings resulting from use of the parent's loss go to it at once. It was this equity that the S. E. C. recognized.

Defendant quotes from an S. E. C. release discussing accounting practice (D. Br. 52), wherein it is said that no part of tax savings is “ordinarily” paid to the loss company. The present

case is not the "ordinary" one. More of the release is quoted in an appendix to defendant's brief (App. pp. 7-14). The text of the release shows that the S. E. C. was not directing its remarks to a case, such as this, where the loss is that of the parent itself. Ordinarily losses are those of subsidiaries, since the parent, not being an operating company, can sustain losses only in the unusual case of worthlessness of its security holdings. The S. E. C. was referring to the normal situation of a continuing economic unity, and the alternatives noted were (a) allocation of all the savings to the affiliate having the loss or (b) sharing it. There is no mention whatever of the third course that defendant espouses—that of grim retention of *all* the savings by the affiliate whose taxes are reduced by use of the parent's loss (D. Br. App. 13).

The Federal Trade Commission investigation mentioned by defendant related to gas and electric holding companies and practices prevailing within groups in which there was a continuing economic entity. What concerned the F. T. C. was the abuse of accounting practices as the result of which amounts paid as or in lieu of federal taxes were added to operating expenses to increase rates.*

Defendant asserts that Treasury rulings "assume and provide" for a pro rata allocation of the tax "without tax saving payments" (D. Br. 56). Nothing could be farther from the truth, and the provisions of the various revenue acts which it cites are the very ones we referred to as recognizing the propriety of agreements between affiliates respecting apportionment (O. B. 53-54). For the protection of the Treasury the regulations list certain circumstances wherein intra-group agreements are not recognized for certain purposes. Defendant refers to these provisions, but they

*The Commission felt that the "amounts paid as federal income tax should be deducted from the net income on which the tax was calculated" and not treated as an expense of operation (D.Br. App. 4, next to last paragraph) and it condemned certain accounting procedures because they resulted in "an inaccurate recording of the true cost of operations of the electric and gas operating companies" (D.Br. App. 3, end of second paragraph). All this is irrelevant to the present case.

are foreign to the case.* The very specification of these instances and purposes shows that for all other purposes the relations of the parties are left to be adjusted by agreement or, in the absence of an agreement, by appropriate principles of equity.†

Nowhere does defendant show any practice where the loss is that of the parent's stock interest in the subsidiary, as is the case here. The reason is obvious, for in the first place the use of such a loss was first authorized in October, 1942, and in the second place this case is unique, "paradoxical" to use the expression of defendant's tax counsel.

*For certain purposes it is necessary to determine earnings and profits available for dividends, and to this end taxes chargeable to each affiliate must be determined. For this calculation the Treasury requires the consolidated tax to be apportioned in a certain manner.

Defendant even refers to the regulation that, if a parent has reduced its own tax by use of a subsidiary's loss, the base at which the parent holds the subsidiary's stock for determining capital gains or losses must be reduced accordingly. The provision merely recognizes the obvious fact that the parent has reduced its investment in the subsidiary by taking advantage of the loss. There is no provision for reduction of the base where a subsidiary takes advantage of a parent's loss, which is the present case. The regulation shows the Treasury's view of the rationale of consolidated returns to be exactly what we contend, namely, that the parent is the ultimate economic owner of the enterprise and the ultimate beneficiary of tax savings. The defendant argues that if the parent has to make a payment to the subsidiary for its loss, the parent would be paying twice. This ignores the fact that there is no reason why a parent should pay a subsidiary for a loss so long as the economic unity continues, in the absence of unusual factors. It would be as absurd as for the head office of a single corporation to pay one of its departments for a loss. See footnote on p. 10, *supra*.

†In its search for support, the defendant finally comes to the Interstate Commerce Commission. It admits that the I.C.C. has never passed on the handling of consolidated returns, but asserts that the Commission has "rejected tax savings claims" (D.Br. 58). The two cases which it cites are not remotely in point. Neither involved the use of one person's losses or tax credits to reduce taxes of another. For example, *St. Louis San Francisco Railway Co. Reorganization*, 257 I.C.C. 399, 410, was a case where a debtor contended that it was entitled to some credit because by failing to pay its creditor all that it owed, the creditor had less income and therefore less taxes.

B. The Fallacious Notion That Tax Savings Cannot Be the Subject of Equitable Cognizance or of an Accounting.

Defendant's essential argument is that the nature of plaintiff's claim cannot be subsumed under the traditional categories of common law liability. Thus it says that plaintiff "suffered no tort; no contract was breached; no statutory right was infringed" (D. Br. 24). It even makes the odd argument that plaintiff should be denied recovery because it has no "title" to the funds from which a judgment would be paid.

But the doctrines of quasi-contract and unjust enrichment have never been restricted to cases of express contract, of torts coming within the scope of common law writs, or of title.

Defendant finally confronts the essential fact of the case—that it has been enriched by use of plaintiff's tax rights—by asserting that plaintiff's claim cannot be the subject of judicial cognizance because a loss is a "negative factor" and a saving in taxes is "a negative concept."

The *Shreveport Bank* cases (discussed at length, O. B. 36-38) show that tax savings or tax advantages are not negative concepts and are the subject of equitable accountability. Defendant entirely ignores this aspect of those cases and merely says that they involve a fiduciary relationship.* (D. Br. 43, 44).

Defendant admits that "if separate returns had been filed" or if plaintiff's stock loss had not been used, there would have been "additional taxes" (D. Br. 25, 26). But it argues that a saving of taxes is not an enrichment because taxpayers have a legal right to take deductions allowed by law, and it quotes a portion of the trial court's opinion that a tax saving is a negative concept because "no benefit could inure from participating in non-payment of an

*Defendant insinuates that the *Shreveport* decision was "over dissent." But the point of the dissent on the second appeal was that still other property belonged to the old bank and that tax savings arising from that property should also have gone to plaintiff. The whole court was in accord that the tax savings were the subject of equitable accountability.

Defendant (Br. 44) cites two cases, *Hopkins v. Detrick*, 97 A.C.A. 55, and *Cooper v. Central Alloy Steel Corporation*, 183 N.E. 439, 43 Ohio App. 455. They are quite irrelevant.

obligation, unless there rested upon the participant an obligation to pay" (D. Br. 13). But here defendant *was* under the obligation to pay \$17,000,000 of taxes and it discharged that obligation by use of plaintiff's rights. The only reason why the law did not require the "additional tax" was that the defendant appropriated and used plaintiff's stock loss and tax rights. Defendant would not have been able to utilize those rights unless it could introduce itself into consolidated returns with plaintiff, a procedure which plaintiff could have denied and which was effected by defendant's directions to plaintiff's president who was in its pay.

Similarly, the assertion that a loss is a "negative factor" is fallacious (see O. B. 74-75). *This* loss was *not* a negative factor, because the tax laws made it of positive value. While this is a case of general equity jurisprudence and not a tax case, the tax laws enter into it as part of the factual background. The tax laws provided that *this* loss could be used in certain circumstances to pay taxes. Therefore this loss had an asset value. It acquired value in precisely the same way as anything has value, to wit, because it had a valuable use.*

And it was actually used in this case to save \$17,000,000.

It is fatuous, we submit, for defendant to deny that value. Rather, it is incumbent on it to justify its arrogation of that value to itself.†

*The argument (e.g., D.Br. 48, 64) that the revenue acts create no private rights misses the point entirely. If defendant had seized cash of plaintiff to pay its taxes, it could not escape liability with this reasoning.

†Elsewhere (D.Br. 45) defendant seeks to distinguish *In re Missouri Pacific Railroad Company*, No. 6935, U.S.D.C., E.D. Mo. (discussed O.B. 54) on the ground that the affiliate whose loss was there used would be subjected to increased taxes by joining in the consolidated return, while here the plaintiff had "no actual damage." This argument concedes that a loss is not a mere negative quantity, and defendant's argument shrinks to the claim that a plaintiff's recovery for seizure of its rights is its detriment and not the other's gain. Our Opening Brief showed how fallacious this contention is (O.B. 66, et seq.), and we discuss the subject further at pages 17-19 below.

Defendant also says of the *Missouri Pacific* case that the others in the group agreed to pay to their affiliate only the amount of its damage, not the amount of their gain. The fact is irrelevant because there the parties

C. The Refusal to Recognize That Defendant Assumed a Fiduciary Relationship to the Plaintiff and Unilaterally Appropriated Plaintiff's Rights, and That the Benefits Were Not Conferred by Plaintiff on Defendant Either Officially or as a Gratuity or by Any Voluntary Act but Were Taken.

Defendant next contends that retention of the benefits would not be unjust because, so it argues, the transfer of plaintiff's tax rights to it cannot be set aside for lack of "some recognized basis—fraud, mistake, duress, undue influence, illegality—for revoking the transfer" (Br. 27-29).*

Thereby defendant's next pervasive fallacy is disclosed. Fraud, mistake, and the like are concepts applicable to a voluntary or affirmative act of transfer. Plaintiff did not knowingly transfer anything to defendant. The latter simply took a thing of value belonging to the plaintiff for its own enrichment. The analogies are trespass and conversion. If a tangible chattel had been involved, it would be a case of tortious conversion, since defendant's conduct was a denial of any interest in the plaintiff.

The fallacy appears sharply at pages 27-29 of the brief. Asserting that "The instances in which a plaintiff who confers a benefit on a defendant fails to obtain a judgment for that benefit are legion," it cites (in a footnote) numerous cases. But these are cases where the plaintiff voluntarily chose to confer benefit, or did so as a gratuity, or where the parties were exchanging benefits each understood to be consideration for the other, or where the plaintiff acted for his own benefit and not for the defendant.

Again, it says that "in every windfall situation," wherever one party acquires a windfall, no one else can recover from him (D. Br. 27-29). Of course, where A receives an advantage which is

agreed as to the allocation of tax savings. The case demonstrates the right to agree, and thus refutes another argument of the defendant that tax savings cannot be the subject of agreement. Where parties freely make an agreement, they may agree on whatever division they choose. Here defendant avoided an agreement by unilateral appropriation of plaintiff's rights.

*It also asserts that nothing "was taken from" plaintiff, but this is the fallacy just discussed.

unrelated to B, the latter has no right to share in it. There was no "windfall" here, for what defendant gained, it gained not as the result of a fortuitous event, but as the direct result of its appropriation of plaintiff's rights.*

The failure to distinguish between a case where a plaintiff voluntarily confers benefits and one where the defendant simply takes them is revealed by the argument that a recovery for unjust enrichment may not exceed plaintiff's loss (D. Br. 29, 30). Defendant invokes the analogy of the discharge of a debt by a surety, who has become such of his own volition, or other purely voluntary discharge by one of another's debt.†

The Restatement of Restitution affirms (Section 153, p. 607) that where A by conduct improper toward B has discharged his

*The cases cited on this point by defendant (D.Br. 28, 29) are largely misdescribed by it. Their actual facts show how far afield defendant strays. In *Straube v. Bowling Green Gas Co.*, 227 S.W.2d 666 (Mo.), plaintiff had paid defendant for gas at the rates fixed by a Public Service Commission and sued for a refund merely because defendant acquired the gas from its own supplier at a legal reduction in the latter's rates. In *Houck v. Hubbard Milling Co.*, 167 N.W. 1039 (Minn.), plaintiff bought wheat from defendant at contract prices and later sued for a refund because defendant had obtained deductions in its own freight rates. The case turned on the construction of the purchase contract. As the court construed that contract, the price at which plaintiff bought wheat was unconnected with defendant's freight rates. *Greek Catholic Congregation v. Plummer*, 32 A.2d 299 (Pa.), is a case where one party quitclaims to another whatever interest he might have in a parcel of land and a third party, the owner, sues for the consideration. In *Russo v. Hosmer*, 44 N.E.2d 641 (Mass.), a subcontractor was denied recovery on his express contract with the main contractor because he had breached the contract in a material respect. He then sought to recover the payments received by the main contractor from the owner. In *Vanderbilt University v. Williams*, 280 S.W. 689 (Tenn.), neither plaintiff nor defendant had a right to receive rent from a third party, but the third party paid rent to the defendant and plaintiff sought a share.

†If the debt is discharged by money payment of less than the face amount, the person discharging it recovers what he paid, and if the debt is discharged with property instead of money he is entitled to its value. These illustrations cast no light on how to determine the value of what is paid. If what is paid is cash, its value is simple to ascertain. If it is not cash, another question arises. Thus defendant returns, this time tacitly, to its fallacy of assuming the plaintiff's stock loss to have had no value. In fact, its value was the benefit conferred, the full amount of the tax savings. The government did not take less than was due it.

debt to a third party by the use of B's property or services, B is entitled to restitution, at his election, either of the value of the property or services so used or of the amount of the debt discharged. The rule is the same where A's conduct as respects B is at fault, although not tortious. *Restatement*, Section 155.

The controlling principle is that "one is entitled to recover for benefit conferred unless he intended to make a gift or acted officiously." (2 Scott on Trusts, sec. 269.3, p. 1520; see O. B. 55, and 66 et seq.)

Truncate v. Universal Pictures, Inc., 76 F. Supp. 465, 469 (quoted O. B. 72) and the *Kentucky Cave* case, *Edwards v. Lee's Adm'r*, 96 S.W.2d 1028, 265 Ky. 418 (discussed O. B. 69-71) refute defendant's attempt to limit plaintiff's recovery to a nominal sum.

Defendant would circumvent the *Kentucky Cave* case by asserting that it was a case of trespass (Br. 46). But the court refused to treat it as a case of trespass because, had it done so, there could be no recovery since there was no "damage." It therefore specifically and in terms decided the case as one of unjust enrichment in which recovery is measured by defendant's profit (pp. 1030-1032).

Moreover, that case cannot be so distinguished because here defendant's use of plaintiff's rights was not consensual. Long before the plaintiff's loss was allowed as a deduction by the government in 1947, defendant had been put on notice of plaintiff's claims by the filing of the suit and by the letter of May 5, 1947 (see O. B. 22). Nevertheless defendant persisted in using plaintiff's loss in defiance of its claim.*

Defendant would distinguish the *Truncate* case as a mere ex-

*In the *Kentucky Cave* case defendant was a "trespasser" and a "wrongdoer" and his act "wilful" only in the sense that he had gone onto the land of another and had not done so accidentally. He did not know that the land was another's. His trespass was far beneath the surface and not until plaintiff sued, upon a "guess," and obtained a survey by court order did anyone know that any part of the cave underlay plaintiff's property (see earlier proceedings, *Edwards v. Sims*, 24 S.W.2d 619, and particularly facts stated at 623).

ample of the rule that corporate directors are not allowed to profit at the expense of their corporation. But the court stated that it had to decide the case on more fundamental principles, because it did not fall within the class of cases where a corporate officer has taken for himself what could have been a corporate advantage or opportunity (76 F. Supp. at 468, 469). The plaintiff was held entitled to all of defendant's gain because "the corporation has been deprived of its freedom of action" even though the corporation could not itself have obtained all of such gain (p. 469).

Defendant denies that there was an appropriation of plaintiff's rights, and is so bold as to assert that what was done was "routine" (D. Br. 21). It could not be routine under a newly enacted law, where the situation was "paradoxical," where the plaintiff by final court decision had just been decreed to have experienced a \$75,000,000 loss and where the amount of taxes involved was \$17,000,000. Defendant never did the normal thing of openly discussing the matter with independent representatives of plaintiff: it ignored plaintiff's existence save to utilize it for its own purposes.

The statement of facts in defendant's brief contains a number of assertions on this subject that are immaterial or erroneous. We shall not reply to them in detail, because on this issue the trial court made a finding of fact in favor of plaintiff. It found that "there is a preponderance of evidence in favor of plaintiff's contention of duality of control" after stating plaintiff's contention to be that

"defendant through its officers and attorneys had controlled * * * plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant" (see O. B. 9).

Defendant's assertion that "the final decisions were necessarily made by the Corporation when it filed the returns" (D. Br. 34) is amazing in the light of the proven facts that the president of the corporation, who was in the pay of defendant, merely signed what was put before him by the defendant's tax attorney.

Defendant's discussion treats Mr. Curry as if *he* were the plaintiff, or as if his capacity were only that of an officer of the plaintiff, when in fact he was in defendant's employ, was also its officer, and his principal work was for it.* Similarly, his competence is exalted, and the notion is sought to be conveyed that he managed and controlled tax matters for the plaintiff, when in fact he acted in a clerical capacity, as office manager, and as a "signing" officer who "signed whatever documents they told you to sign" (642). The admitted competence with which he performed these limited functions did not exalt him into a directing figure, for in all other respects he was, as he admitted in response to a question from the bench, a "figurehead" (646-7).

Matters pertaining to taxes were put before him for signing after they were prepared by others over whom he had "supervision" only in the sense that he was office manager, and he had no real understanding of them (e. g., 807-809).

The truth as to the preparation of the tax returns is disclosed by memoranda passing between Mr. Coulson and Mr. Polk, the defendant's tax attorneys. Mr. Coulson wrote:

"Actually, I happen to know that the only person over at the Corporation office here in New York who has any knowledge of taxes is a girl who is primarily Schumacher's Secretary [Valouch]." (539 P. 38)

Polk replied that "only the lady referred to had any part in the preparation of the return" (540 P. 384).

The fact, as both Curry and Polk testified, is that the returns were prepared by Valouch and Polk's accountant, Reilly, under Polk's direction (1403) and signed by Curry because told that they had Polk's approval (823).

Defendant argues that some of plaintiff's officers were both

*Defendant asserts (D.Br. 16) that Curry was never an officer of the defendant after its reorganization. The fact is otherwise. He was its vice president, assistant secretary and assistant treasurer until April 30, 1945, months after the revestment (P. Ex. 2-A, chart), was in the retainer of its tax counsel until late in 1947, and at all times received a pension from it (O.B. 13).

competent and informed (D. Br. 32). But consider the situation of the individuals named. Mr. Schumacher was one of the defendant's trustees. Mr. Campbell was counsel for defendant and the trustees and received his compensation from them (P 2A, reproduced in our opening brief).

Messrs. Wood and Osborn never knew until 1946 that plaintiff's stock loss was being used in the consolidated returns. It is no answer to say that these two understood that consolidated returns were being filed (D. Br. 16, 17, 34). The idea of using the loss in such returns was a mere speculation of a possibility when it was first thought of in May, 1943, "commented on rather than suggested * * * since it is paradoxical" (see O. B. 17), rejected by the defendant's counsel for that reason until December, 1943 (1448, 1484) and never brought home to Messrs. Wood or Osborn (see Osborn, 1022, 1023; Wood, 1129-1131).

Defendant discusses Mr. Nicodemus in order to show, it seems, some sort of knowledge by him of the filing of consolidated returns.* His knowledge, whatever it was, cannot affect plaintiff. He was only an attorney for it, not an officer or director, and he was also an attorney for the defendant. Even if plaintiff's officers and directors had known of the utilization of its loss, had realized the legal and economic consequences, and with that knowledge had attempted to give away its rights, they could not bind it, because it was not represented by independent officers, and because any attempt to give away its rights without the consent of its stockholders would be beyond its powers (see O. B. 55, 56).

For the same reason defendant's discussion of a casual conversation of Mr. Nicodemus with some attorneys who represented no parties in this case is pointless (D. Br. 34). The trial court dis-

*The manner in which defendant seeks to show his knowledge is shown by the statement (D.Br. 10) that "Mr. Curry understood that Mr. Nicodemus knew * * *." Mr. Curry's suppositions are irrelevant.

Defendant denies that Polk sent the "paradox letter" to the defendant and asserts that he sent it to Curry and that Curry sent a copy to Nicodemus (D.Br. 16). The letter was addressed and sent to Curry as defendant's vice president (588) and, as such, he transmitted it to Nicodemus as defendant's attorney (1884).

missed the subject as quite irrelevant (1075).^{*} In fact, in these conversations Mr. Nicodemus did not have in mind the use of the stock loss (1071).

Defendant even seeks to clothe its present refusal to do equity in the mantle of the general esteem all bear for Judge Sloss. More than once it says that Judge Sloss represented the plaintiff (D. Br. 6, 34). But Judge Sloss was plaintiff's attorney on a specific assignment, to oppose the Plan of Reorganization. He had no other function and was interested in nothing else. He knew nothing whatever about the tax matter (1603-5, 1611-14).

D. The Fallacy That Plaintiff Was Under a Duty to Make a Gift of Its Rights to Defendant.

While defendant denies that it was in the position of a fiduciary toward plaintiff, it does not state why. Instead it asserts that plaintiff had fiduciary responsibilities to the defendant! This contention rests on the fact that plaintiff had once been the parent corporation. Its fallacies are self-evident. What makes one a fiduciary is the element of dominance and the exercise of control and management (see O. B. 60). Here:

1. Plaintiff had no control whatever as a stockholder or otherwise. It had had no share in management after the trustees were appointed in 1935. And the Plan of Reorganization cut off any possibility that control, management, or financial interest would ever return to it.

2. Plaintiff had become a total economic stranger to defendant.

Defendant ignores the unique and distinguishing fact of the case, the severance of the economic unity. Plaintiff at the times involved here had no control over, management of, financial interest in, or duties toward defendant.†

^{*}The Court said (1075, 1076):

"I do not see that when this witness learned about any of these things has any relationship to the question that you are presenting here. * * * I would much rather hear your arguments and all the arguments on the important and vital issues of this case than all this stuff about what conversations this witness had with some lawyer on a train going to Washington."

†For a time plaintiff held certain pieces of paper, quondam stock certificates, but they had been judicially declared to represent no stock interest in

Defendant's argument is simply a bold assertion that plaintiff was under a duty to make a gratuitous donation of its rights to the defendant for the latter's enrichment. This is not reasoning. It merely assumes the answer to the issue involved in the case.

The same fallacy underlies Part III of defendant's brief, where it is contended that plaintiff's claim is "inequitable" (D. Br. 65-67, also 59, 60). It is argued that the pre-reorganization creditors of defendant were not paid in full, and that creditors have an absolute priority over stockholders. But the conclusion sought to be drawn is a non-sequitur. The creditors *did* receive absolute priority. Plaintiff, the stockholder, had its equity completely wiped out, and the old creditors became the stockholders of the reorganized company as well as its bondholders.

Plaintiff does not ask that it receive an equity interest in that company. It seeks an accounting for use of *other* rights or assets of the plaintiff to the defendant's enrichment, rights and assets not involved in the reorganization. Creditors of a reorganized company, after squeezing out the former shareholders, have no right to seize other property of the former shareholders. Could the reorganized defendant company seize \$17,000,000 cash of the plaintiff to pay defendant's taxes and escape the duty to account, because pre-reorganization creditors had never been paid in full? Obviously not. (See discussion, O. B. 88-95 and page 26, *infra*.*

defendant. And it did not even hold these at the times the tax returns were filed.

Defendant argues that obligations of a fiduciary may continue after termination of the relationship, but this could be true only so long as duties of the position remained to be performed. Plaintiff had no such duties in the premises toward defendant.

*As part of this argument defendant asks the Court to take judicial notice of stock market quotations of its stock in 1949 and 1950 (D.Br. 67)! Defendant offered evidence of quotations in 1945 and 1946, and that evidence was excluded (1579-1583). It complains that creditors took stock under the Plan of Reorganization on the assumption that the preferred stock was worth \$100 per share and the common \$57. If the Court could take judicial notice, which we deny, it would find that the preferred stock sold as high as 101 (in April 1946) and the common stock as high as 57 1/8 (in July 1945), dates shortly following the consummation of the reorganization, all as shown by the excluded evidence (2042, 2043). The later vicissitudes of the market cannot be relevant.

Even controlling stockholders of a corporation are under no duty to make a free-will offering to it or to its creditors of other property belonging to them. Much less so are ex-stockholders.

In this connection defendant makes certain invidious assertions. It states that when plaintiff controlled defendant it caused the latter to sell securities to the public, and that defendant went into bankruptcy because of plaintiff's unsuccessful management (D. Br. 4 and 66). The fact is the plaintiff was itself controlled in those years by the James interests who owned 61% of its common stock and 8.8% of its preferred stock (admitted, D. Br. 3). These were the controlling human agents responsible for what occurred. As the result of defendant's reorganization, the James interests became the controlling power in defendant. If plaintiff's suit is defeated, the James interests will profit greatly (see O. B. 11, 13, 14).

Defendant argues that the bankruptcy court could have compelled the plaintiff to join in consolidated returns for defendant's benefit (D. Br. 40). The reason it gives for this contention is that a bankruptcy court has the powers of a court of equity—an irrelevance, since (1) a bankruptcy court has those powers only within the limits of its bankruptcy jurisdiction, and (2) defendant fails to adduce any basis for an equity to compel plaintiff to join in returns for defendant's benefit. We have shown in our Opening Brief that there would have been no such equity. (See O. B. 51-55.) We also showed that the bankruptcy court would have had no jurisdiction to enter any such order (O. B. 52).*

*The controlling cases on jurisdiction are *Benton v. Callaway*, 165 F.2d 877, and *Callaway v. Benton*, 336 U.S. 132.

Of these cases defendant merely says (D.Br. 41) that they involved the power of the reorganization court over a stranger to the proceedings, and that plaintiff here was a party. But plaintiff appeared only to present its views in opposition to the Plan of Reorganization. It thereby submitted itself to the jurisdiction of the bankruptcy court only to assert its claims, as stockholder or bondholder, against the debtor, not to give the court jurisdiction over demands which a debtor might assert against it. In the *Callaway* case the litigant, South Western, had appeared in the reorganization proceedings to ask that its lease be adopted by the reorganized debtor (see 336 U.S. 132 at 134 and 135), and it was also a creditor in the proceedings (p. 146). Yet the Court of Appeals said that those facts gave no

Revealing defendant's attitude are its arguments (D. Br. 40) that *if* it had openly come to plaintiff to ask for the use of plaintiff's rights, it would have been a "levy of tribute" or "exacting a price for a signature" for plaintiff to decline to give away its valuable rights and its assertion that equity does not countenance hard bargains. Here defendant gave plaintiff no opportunity to bargain. Taking advantage of the fiduciary relationship, it appropriated what belonged to the plaintiff.*

II.

THERE IS NO MERIT TO DEFENDANT'S CONTENTION THAT PLAINTIFF'S CLAIMS, THOUGH VALID, SHOULD BE DENIED BECAUSE OF THE REORGANIZATION PROCEEDINGS.

The last part of defendant's brief is devoted to the contention that even if plaintiff "had a valid claim" it has been barred by the reorganization proceedings, because not presented to and approved by the Bankruptcy Court (D. Br. 68-83). Defendant argues that even though the plaintiff and its stockholders are justly entitled to recover \$17,000,000 from the defendant, they are to be denied that recovery, because the decree of the Bankruptcy Court destroyed their claim.

This harsh contention is sustained by neither the facts nor the law.

jurisdiction to the reorganization court to compel it to convey rights to the debtor. 165 F.2d 877 at 882. And the Supreme Court agreed. 336 U.S. at 146.

*If A covets something of value belonging to B, the parties may by mutual agreement determine the terms and consideration upon which B will accede to A's desires. *Sekulow v. 11th & F. St. Valet, Inc.*, 162 F.2d 19 (D.C. Cir. 1947); 5 *Williston on Contracts* (Rev. ed.), Sec. 1606; *French v. Shoemaker*, 14 Wall. 314, 333; *Truncale v. Universal Pictures, Inc.*, 76 F. Supp. 465.

The cases cited about "exacting a price for a signature" are cases where A sells or assigns something to B "who had bought and paid for" all A's rights and interests and to make the sale effective a signature to some form was later necessary (e.g., *Kelley v. Caplice*, 23 Kan. 474) or cases likened by the court to selling a vote on a public question (*Lain v. Rennert*, 32 N.E.2d 375 (Ill. App.)).

A. Plaintiff's Claim Is Not Remotely in Derogation of the Policy of Section 77 of the Bankruptcy Act or the Purpose of Defendant's Reorganization.

Defendant first asserts that plaintiff's claim is contrary to the policy of Section 77 of the Bankruptcy Act (D. Br. 68-71). The assertion lacks merit. We so showed in our Opening Brief (pp. 88-95), and we now note, merely by way of recapitulation, the following facts. The tax savings had no bearing whatever on the plan of reorganization of the defendant. Those savings were unanticipated. The Plan contemplated that the taxes be paid. It was approved by the court, consented to by the creditors, confirmed and put into effect before anything was done from which the savings arose.* Thereafter plaintiff's rights were appropriated to give defendant an unexpected and unjust enrichment.

There is no policy in Section 77 that after a reorganization the reorganized company may appropriate rights or assets of another to its own enrichment without a duty to account.

B. Plaintiff's Claims Arose After the Revesting of the Railroad Properties in Defendant.

The properties revested in defendant on December 31, 1944, and the trustees then surrendered control of operations to it (O. B. 26).

*Defendant's brief (p. 75) asserts that persons who participate in the reorganization as creditors or otherwise are entitled to an exact statement of the assets available for the new concern and a precise definition of its liabilities, and cites *In re Colorado & S. R. Co.*, 84 F. Supp. 134. That case arose under the *McLaughlin Act* (56 Stat. 787), which inserted a new and temporary chapter (Ch. XV) into the Bankruptcy Act. The *McLaughlin Act* contained special provisions for notice to the Secretary of the Treasury relative to taxes, binding the United States if it failed to appear within a given time (Secs. 722 and 738). The case did not involve claims arising from a trustee's operations but pertained to taxes accrued before the court acted on the petition which commenced the proceedings. What the court said was that if the United States had presented a claim for additional taxes, it would have made the plan of adjustment unacceptable to the creditors who otherwise gave the assents without which the plan could not have been approved.

In the present case, the tax savings arose from acts occurring after the plan was approved, consented to, confirmed and consummated.

Patently, if the plaintiff's claims arose afterwards, the reorganization proceedings could not bar them.

Liabilities and obligations arising from use of another's property or rights by a post-reorganization company may be enforced without impairment by reason of the reorganization proceedings. *Seaboard Air Line R. Co. v. Savannah Union Station Co.*, 181 F.2d 267 (5 Cir.).

Plaintiff's claims did arise after the reorganization. This is self-evident as to claims with respect to the 1944 taxes and the refund of 1942 taxes. The claim for refund was filed in March, 1945—21½ months after the reorganization was over—and the 1944 return was filed in June, 1945. The trustees had nothing to do with either. The filing of these papers was strictly the act of defendant.

Defendant argues that the income to which the 1944 return and the claim for refund pertained had accrued while the railroad was being operated by the trustees. But the obligation to pay the taxes on that income was assumed by the defendant by means of the Assumption Agreement (see O. B. 90). The liability thereafter remaining was that of the defendant, not the trustees. It was the defendant and not the trustees who then utilized plaintiff's loss and rights to avoid paying taxes and to discharge that liability.

As respects the 1943 taxes, although the returns were filed in July, 1944, the claim for recovery or an accounting of the tax savings relative to that year could not accrue before there were tax savings, i. e., not earlier than August, 1947, when the government finally accepted the returns pursuant to the settlement. And it accrued when defendant refused to account. The failure to account was the wrongdoing.

When the trustees turned over the assets to the defendant in December, 1944, among those assets were \$7,100,000 in government bonds, earmarked as a reserve for the payment of 1943 taxes. The tax savings resulted from the subsequent acts of the defendant in adopting the returns as filed, and in the name of plaintiff prevailing upon the tax authorities to accept them. For

example, defendant's Annual Report for 1944, issued in May, 1945 (5 months after it was out of reorganization), refers to the reserves as maintained to protect the defendant in the event of "a ruling adverse to the Company's contention that it was not liable for any Federal income or excess profits taxes for the calendar year 1943 and the first four months of 1944" (514 P. 20-C). It will be noted that mention is here made of the Company, not of the trustees.*

As defendant's witness, Mr. Polk, testified, "this was a doubtful item and it was not until the Bureau had finally allowed the settlement that I knew that we had the benefit of it" and "* * * any action [about tax savings] was premature until the liability to the government was determined. You cannot calculate any savings until you know * * * the liability under the returns as filed" (1459, 1460).

The Bureau's field examiner concluded in May, 1946, that the deduction should be disallowed.† Tax counsel then took the matter up with the Internal Revenue Agent in Charge. In order to do this, he had to procure a power of attorney from the plaintiff, through Mr. Curry (1424). Filing the power of attorney was an act of the defendant, not of the trustees, and but for it there would have been no tax saving. The first letter to the Agent was written May 31, 1946 (O. B. 20).

After an adverse conclusion of the Agent, the matter was

*The 1943 returns had been filed, not in the name of the trustees, but in the name of defendant as an affiliate of plaintiff, and the returns were signed, not by the trustees or by Mr. Elsey as their agent, but by him as defendant's president. (See in P. 4A the "Return of Information and Authorization and Consent of Subsidiary Corporation Included in a Consolidated Income Tax Return.")

The Plan of Reorganization itself contemplated that, vis-a-vis the creditors who were to become the stockholders of the reorganized Company, the income after January 1, 1939 was to be treated as if the reorganized Company had come into ownership and possession of the properties on January 1, 1939 (2183 D. 23A, para. 7).

†The government's audit of the returns did not even become active until the latter part of 1945 (1419), the field examiner did not complete his work of examining the returns until May 1946 (1423), and the audit was not completed by April 1947 (1788).

taken to the office of the Commissioner of Internal Revenue in Washington and there settled (1426, et seq.). None of this involved any acts of the trustees.

Before the tax settlement in 1947 defendant had already been advised in writing that plaintiff expected an accounting of the tax savings, if defendant succeeded in having the government accept the returns as filed (O. B. 22). Defendant had its choice then whether to seek to have those returns accepted or not. The tax savings were the result of its action at that time.

C. If Any Part of Plaintiff's Claims Arose Before Revesting, the Reorganization Court Required Them to Be Assumed, and They Were Assumed, by Defendant; the Court Made No Order Barring the Claims.

Defendant seeks to avoid the fact that the plaintiff's claim relative to the 1943 taxes accrued after the close of the reorganization proceedings by arguing that theretofore it was executory or contingent, and it then argues that the claim is barred.

The argument is permeated with numerous erroneous assumptions of fact and fallacies of law, as we shall now show.

In the first place, if those claims accrued before December 31, 1944, or existed even contingently, they were expressly assumed by defendant.

The bankruptcy court decreed no bar of claims except such as may be found in the "revesting order" of November 27, 1944 (36). Paragraph 11 of that order fixed the date of the consummation of the Plan as December 29, 1944, and provided that "the said Railroad Company shall thereupon be forever released and discharged from all of *its* debts, obligations and liabilities, *except as herein provided*" (51, 52).

This was no bar to the present claim, for two reasons. First, the bar relates to "its" debts, i. e., those of the railroad company existing at the time reorganization proceedings commenced in 1935, not to claims arising from the trustees' acts (see pp. 34-39, *infra*). Second, the revesting order expressly excepted from its bar certain obligations. In paragraph 8 it "authorized and directed" defendant "to execute and deliver * * *

(a) agreement providing for the assumption of certain obligations, liabilities, contracts, agreements and leases of the debtor and the debtor's Trustees, substantially in the form attached to this order as 'Exhibit D', the form and provisions of which are hereby approved;" (45, 46).

An Assumption Agreement was then executed by defendant in December, 1944 (see O. B. 26). Therein defendant agreed to:

"2. *Assume any and all outstanding current liabilities and obligations incurred by said Trustees * * * and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor's properties by said Trustees, or their conduct of the debtor's business, including liabilities and obligations hereafter arising up to midnight December 31, 1944.*" (1711, 1713.)

Defendant tries to restrict this assumption to less than *all* the trustees' obligations, by reference to various inapplicable language of the revesting order and the Plan of Reorganization (D. Br. 77). But the Assumption Agreement says "all," it is in the exact form attached to the revesting order and, in finding (e) of that order the court found that this agreement providing

"for the assumption of obligations, liabilities * * * which are to be assumed by the reorganized company pursuant to the plan of reorganization, is consistent with and conforms to the plan of reorganization * * *." (40.)

Not only is the language of the agreement all-comprehensive, it was so construed by the court. By order of May 21, 1945, approving the trustees' final report, the court found in paragraph 4 that by the Assumption Agreement the "Debtor Company assumed and agreed to perform *all* contracts, leases, agreements, liabilities and obligations of the Trustees remaining in effect on December 31, 1944" (1987, 1988).

Defendant's attempt to qualify the breadth of the Assumption Agreement is based, essentially, on the provisions of paragraph 10 of the revesting order that defendant was to pay expenses and

costs of administration in such amounts as were determined by the court (D. Br. 77). Defendant tries to squeeze plaintiff's claims into the pigeonhole of expenses of administration and bar them for lack of presentation to the bankruptcy court. The argument is without merit.

As used in the particular reorganization proceedings the term "expenses of reorganization" was not co-extensive with all obligations arising from the trustees' acts. This fact is apparent from many provisions of the Plan and the Revesting Order, but it is sufficient merely to review subdivision Q of the Plan, which defendant quotes (D. Br. 78). That subdivision treats of two different groups of claims: (1) those that must be paid in cash or that the reorganized company must agree to assume by entering into an express assumption agreement, and (2) those that it must be deemed to have assumed, i. e., in regard to which an assumption would be implied.

The second group consisted of express contracts of an executory nature extending beyond the reorganization and remaining to be performed thereafter. Patently it is not here involved, although defendant refers to it (D. Br. 78).

The first and pertinent group includes four kinds of claims:

(a) Claims existing against the debtor prior to the commencement of the bankruptcy and entitled to priority over the mortgages;

(b) current liabilities;

(c) "obligations incurred by the trustees of the properties of the debtor during the reorganization proceedings";* and

(d) expenses of reorganization.

Paragraph 10 of the revesting order effectuates the provisions of the Plan concerning expenses of administration. But it is paragraph 8(a) which effectuates the generality of the provisions of the Plan relative to "obligations" (46).† And that paragraph

*In its trial brief (p. 126) defendant conceded that "'obligations' may have a different scope" than "current liabilities." In its present brief it blandly treats them as synonymous.

†Defendant even discusses paragraph 15, which relates only to assertion of liens or the attachment of property (D.Br. 79).

required the defendant to execute the prescribed Assumption Agreement and thereby to assume claims of any character, "whether heretofore *or hereafter* asserted arising out of * * * their [the trustees'] conduct of the debtor's business," and it did not limit the assumption to obligations first presented and approved by the bankruptcy court. The explicit mention of claims "hereafter asserted" so shows.

The revesting order, and the petition on which it was granted, were both prepared by Mr. Coulson's firm (36, 1699). That firm is now counsel for defendant in this case. Mr. Coulson never supposed that the order had the meaning that he now advocates. On November 15, 1948, he submitted his bill to defendant for \$300,000 for tax services rendered in part to the trustees in connection with the subject matter of this suit (1749). If the Assumption Agreement covered only claims first presented to and approved by the reorganization court, Mr. Coulson's claim would be barred.

Defendant notes that in some cases it has been held that for certain purposes taxes accruing during receivership are expenses of administration. Apparently defendant deduces, although silently, that plaintiffs' claim must be regarded as of the same character as the obligation to pay taxes.

The argument is self-defeating. The term "costs and expenses of administration" as used in the defendant's reorganization proceedings did not include taxes. The Plan explicitly provided (233 I.C.C. at 455) that

"Notwithstanding any other provisions of this modified order, the reorganized company shall assume the liability for, and shall pay in full in due course, any and all taxes due to the United States from the debtor or the debtor's trustees for any taxable period prior to the date of the confirmation of the plan, *whether or not proof thereof has been made in the proceeding and without prejudice by reason of not having made proof thereof.*"

Similarly, while the revesting order referred to "costs and expenses of administration" in paragraphs 10 and 20, it referred

to taxes in paragraph 9 and it there provided that the defendant must

"assume liability for, and pay in due course, any and all taxes lawfully due to the United States from the debtor or the debtor's Trustees for any taxable period prior to January 1, 1945, *whether or not proof thereof was made in said proceeding and without prejudice by reason of such proof not having been made.*" (49)

The notion that the obligation to account to the plaintiff could fall within the narrow confines of the expression "costs and expenses of administration" has no substance. A receiver's office expenses or the salaries of his clerical help are expenses of administration, but if the receiver robs a bank or seizes and sells the property of another to obtain funds to pay his office expenses or clerical salaries, the liability to account to the owner can hardly be so denominated.

FINAL ORDER.

Defendant also refers to the final order of March 28, 1946 (D. Br. 80). But the defendant, its assets and operations had been out of the trustees' hands since December 31, 1944, and the "final order" merely settled the personal accounts and formally closed the files of the court on the case. So far as any bar is involved, that order merely adopted the provisions of the revesting order of November, 1944. Therefore, it barred only such claims as existed on or before December 31, 1944, and it exempted from that bar all claims exempted by the revesting order, i. e., those covered by the Assumption Agreement.

D. Plaintiff's Claims Did Not Have to Be Approved by the Bankruptcy Court.

Defendant argues that plaintiff's claims, though valid, are barred by failure to have them approved by the bankruptcy court.

As respects the 1944 returns and the claim for refund there is not the remotest basis for the contention. The property had already been surrendered to the defendant. As said in *Texas and Pacific Railway Company v. Johnson*, 151 U.S. 81 at 103:

"* * * we are aware of no principle which would justify us in holding that a court, under the circumstances which existed here, could part with its jurisdiction over property by the complete surrender thereof to its owner, and at the same time constructively retain jurisdiction over such property so as in that respect to bind those who would otherwise be unaffected by its orders."

Here the reorganization court did not even purport to reserve jurisdiction to supervise claims arising after the revesting.*

Nor is defendant's contention correct as respects the 1943 taxes. A basic fallacy is its failure to observe the distinction between obligations of the debtor existing at the onset of the proceedings and obligations arising from acts of the court's officers.

At the moment when any plan of reorganization under Section 77 of the Bankruptcy Act is to be consummated, four possible classes of liabilities may be in existence: (1) Personal liability of the *debtor itself* for *its* own debts and liabilities, i. e., debts existing at the commencement of the reorganization proceedings; (2) liability of the *property and assets* in the hands of the trustees to pay these debts and to pay the claims of stockholders, as stockholders; (3) personal liability of *the trustees* to pay obligations arising from *their* operations; (4) liability of the *property and assets* to pay the latter class of obligations.

The policy of the law is to discharge claims of the first three classes but not of the fourth. The integrity of the courts requires that claims arising from the acts of their officers be paid, and it is settled practice that such claims are assumed by the party to whom the assets are transferred.

Subdivision (f) of Section 77† provides:

*Nor could it. As said in *Reese v. Beacon Hotel Corporation*, 149 F.2d 610 at 611: "* * * reservation of jurisdiction beyond what is requisite to effectuate a plan of reorganization is beyond the power of the reorganization court." Here the plan was formulated, approved and confirmed before anything was done that eventually led to the tax savings. Cf. *Callaway v. Benton*, 336 U.S. 132.

†Title 11 U.S.C.A. Sec. 205 (f), p. 190.

"The property dealt with by the plan, when transferred and conveyed to the debtor or to the other corporation or corporations provided for by the plan, or when retained by the debtor pursuant to the plan, shall be free and clear of *all claims of the debtor, its stockholders and creditors*, and the *debtor* shall be discharged from *its* debts and liabilities, except such as may consistently with the provisions of the plan be reserved in the order confirming the plan or directing such transfer and conveyance or retention * * *. Upon the termination of the proceedings a final decree shall be entered *discharging the trustee* or trustees, and making such provisions as may be equitable, by way of injunction or otherwise, and closing the case."

Thus, while provision is made to discharge the debtor and the assets from claims existing at the commencement of the reorganization and to discharge the trustees personally, no provision is made for freeing the assets from liabilities arising from the trustees' operations.

Here, the Assumption Agreement carried out the policy of the law by imposing on defendant the affirmative duty to pay such liabilities.

The provisions of Section 77 "carr[y] with [them] the application to railroad reorganizations of decisions and authorities originally applicable to equity receiverships." 5 *Collier on Bankruptcy* (14th ed.) P. 493, citing *In re Southwestern Ry. Co.*, 17 F. Supp. 68, aff'd 88 F.2d 163.*

*Proceedings under Section 77 are essentially enlarged receivership proceedings, freed of territorial limitations and with title to the debtor's assets vesting in trustees. 5 *Collier*, p. 467. Unlike ordinary or traditional bankruptcy proceedings, their purpose is not to liquidate the debtor but to rehabilitate it and to preserve its operations. 5 *Collier*, p. 468; *Thompson v. State of Louisiana*, 98 F.2d 108 (8 Cir.); *Lowden v. State Corp Comm'r*, 76 P.2d 1139; 42 N.M. 254.

Section 77, subd. (a) (11 U.S.C.A., Sec. 205(a) at p. 179) confers on the court "all the powers not inconsistent with this section, which a Federal court would have had if it had appointed a receiver in equity of the property of the debtor for any purpose." Subdivision (c) (2) provides that the trustee "shall have all the title and shall exercise * * * to the extent not inconsistent with this section, if authorized by the judge, the

The principles in railroad receiverships were well settled when Section 77 was enacted. When the assets of the debtor were sold to pay its debts, it was the practice to require the purchaser to assume all liabilities arising from the receiver's acts, and the purchaser became personally liable, thus preserving the claims, although the receiver himself was personally discharged. Cf. *Hanlon v. Smith*, 175 Fed. 192; 1 *Clark on Receivers* (2d ed.) Section 494, at p. 677. When the assets were not sold but were returned to the debtor, enriched or bettered by the receiver's acts or operations, the party receiving them was held liable for the claims arising out of the receiver's acts even though the claims were not presented to the receivership court within a time fixed by it. An assumption arose by implication of law. Cf. discussion in *Bartlett v. Cicero Light, Heat & Power Co.* (Ill.), 52 N.E. 339 at 341, 342; 177 Ill. 68.*

Leading cases are *Texas & Pacific Railway Company v. Johnson*, 151 U.S. 81, and *Texas & Pacific Railway Company v. Bloom*, 164 U.S. 636. There, during receivership the earnings of the railroad were applied to payments of debts and to betterments. The order directing the receiver to deliver the assets back to the railroad discharged him as of the date of revesting and contained a provision directing claims to be filed on a day certain under penalty of being forever barred (164 U.S. 638, 639).

The Supreme Court held that since an order barring claims arising from the Receiver's acts would be highly unfair, any bar order entered should be strictly construed so as not to have that effect. The court emphasized that two purposes are to be served

powers of a receiver in an equity proceeding * * * (11 U.S.C.A. Sec. 205(c) (2) at p. 183).

Here the powers of a receiver in equity were conferred on the trustees by order of November 9, 1935 (1923, 1928 D 22).

*See also *Glenn on Liquidation*, Sec. 165, pp. 273, 274; *Clark on Receivers*, Sec. 495, p. 677; *Stuart v. Dickinson*, 235 S.W. 446, 456; 290 Mo. 516; *Anderson v. Chicago, R. I. & P. R. R. Co.*, 175 N.W. 583; 189 Iowa 739. A full discussion appears in 45 *Am. Jur.* 276, Sec. 345. Among other things it is there said:

"Furthermore, a railroad company is liable for any claim which should have been paid by the receiver out of the earnings of the railroad, although the claim is not established by intervention within the time fixed by the order of the court."

when a receivership is to be closed: (1) The receiver should be protected; but (2) the court should see that all just claims arising from his conduct are protected.

These purposes were attained by construing the bar order as cutting off the receiver's personal liability and precluding subsequent recourse in the receivership proceedings but as not precluding recourse in any other competent forum against the party receiving the assets, despite lack of filing of the claims in the receivership court. An implied assumption by the company arose from the receipt of the assets which had been enriched by the receiver's acts.* *Johnson*, 151 U.S. at 104 to 106; *Bloom*, 164 U.S. at 640, 641.

Plaintiff's position here is stronger than that of *Bloom* or *Johnson*. In those cases there was no express assumption of the receiver's obligations. The assumption was implied on principles of unjust enrichment. Here we not only have all the facts of enrichment sufficient to create an implied assumption, but we also have an express agreement of assumption. In those cases, too, while the assets were enriched, there was no relation between the enrichment and the particular claims asserted. Here, not only were the assets greatly enriched and bettered upon revesting in defendant (see O. B. 28, 94), but there is an immediate and direct causal relationship between the activities giving rise to the obligation and the increase of assets in the defendant's hands. Defendant's assets are enriched by the precise amount of the tax savings. In those cases there was an order directing claims arising from the receiver's acts to be presented on a given date under penalty of being barred. Here there was no such order.

Defendant asserts (D. Br. 70) that "reorganization must put an end to all outstanding claims" and quotes a passage from *Duryee v. Erie R. Co.*, 175 F.2d 58 and one from 6 *Collier on Bankruptcy* (14th ed.) Sec. 11.18, pp. 3922-24, relative to proceedings under Chapter X (former Sec. 77B). But the *Duryee* case was speaking "of a claim existing prior to the reorganization

*Cf. *California Civil Code*, Section 3521: "He who takes the benefit must bear the burden."

proceedings" (p. 61 and headnote 1). And Collier's reference to the discharge of "liabilities incurred during reorganization" relates to obligations incurred by the debtor itself, not to those arising from the trustees' acts. This is shown not only by the language of the text but by the only case cited by Collier in support of the phrase, *Peavy-Byrnes Lumber Co., Inc. v. Long-Bell Lumber Co.*, 55 F. Supp. 654.

ABSENCE OF NOTICE TO PRESENT CLAIMS.

If the court had power under Section 77 to bar claims arising from the trustees' acts for failure of presentation, it could not exercise that power without giving notice.

Any attempt to do so would violate due process. *In re Central R. Co. of New Jersey*, 136 F.2d 633 (3 Cir.), cer. den. 320 U.S. 805. *In re Glenn-Colusa Irrigation District*, 62 F. Supp. 65 (N.D. Cal.). "Notice is a very essential feature of the Bankruptcy Act if the rights of creditors are to be limited or curtailed," *Investment Building v. Finance Co. of America*, 105 F.2d 345 at 347 (3 Cir.). And see *Texas & Pacific Railway v. Johnson*, 151 U.S. 81 at 103.

Moreover, if there is any power in a court under Section 77 to bar claims arising from the conduct of receivers or trustees, that power is governed by subsection (c) (8), which prescribes that

"The judge shall cause reasonable notice of the period in which claims may be filed * * * to be given creditors and stockholders by publication or otherwise."

Here no notice was given to claimants to present any claims arising from the trustees' operations, as distinguished from claims existing against the debtor at the time proceedings were instituted in 1935. Nor did the court make any order directing that such notice be given.

It is obvious why no such order was made: No bar was intended.* As a matter of construction, the absence of such an order

*In *Investment Building v. Finance Co. of America*, supra, where a notice was given to certain class of creditors but there was no order requiring it to be given, that fact was held to show the court had no intention to bar the claims of the class.

and of notice confirms that the Assumption Agreement was intended to be as broad and as complete as its language indicates.*

Defendant relies on this Court's decision in *McColgan v. Maier Brewing Co.*, 134 F.2d 385 (D. Br. 74). There an involuntary petition in ordinary bankruptcy had been filed against a corporation. It was operated by a receiver until a plan of composition was approved, the business was restored to the debtor, and the receiver discharged. Later it went into 77B proceedings, and the question was whether a claim for state franchise taxes for the years when the business was being operated by the receiver in the first bankruptcy should be recognized, the claim not having then been presented in the first proceedings. This Court twice emphasized that notice had been given directing such claims be filed under peril of being barred.†

Moreover, there was no showing that during the receivership there had been any enrichment of the estate by the receiver's operations as by devoting funds received from the operations to payments of debts or to the making of improvements or betterments.‡

Defendant's argument ignores the element of enrichment of the trust estate by the trustees' acts and the revesting of the estate, so enriched, in the defendant. In the *McColgan* case this Court

*Defendant quotes a passage from *Collier on Bankruptcy* relative to discharge of holders of claims who have had no notice (D.Br. 70). This pertains to cases where the court directed notice to be given and it was given as prescribed, but where there was no showing that a particular claimant had received it. Since the identity of creditors may be unknown, notice may not in fact come to a particular claimant's attention. It is to this situation only that Collier's statement applies, as shown by his principal citation, *North American Car Corporation v. Peerless W. & V. Mach. Corporation*, 143 F.2d 938 (2 Cir.).

†It said:

"During the course of the proceedings numerous notices were published in Southern California newspapers, pursuant to court order, directing all persons having claims to present them" (p. 386).

"* * * Persons having demands against the receiver or claiming rights to participate in the estate were repeatedly given notice to come in and make their demands known" (p. 388).

‡This Court concluded by saying (p. 388), "It is said that the corporation was unjustly enriched through the nonpayment of these taxes, but we do not know that to be true."

relied on a "general rule" as stated in 1 *Clark on Receivers* (2nd ed. 1929), p. 1008 (misprinted as p. 108). On the next page Clark states:

"When a receiver is about to be discharged and the property redelivered to the owner, the receiver on the one hand is entitled to protection from liability, and on the other hand, just claims are entitled to be paid. In such cases provision is generally made for operation liabilities during the receivership and judgments rendered or to be rendered in favor of the interveners."

Such provision was here made by the revesting order and the Assumption Agreement.

ANSWER TO DEFENDANT'S CONTENTION ABOUT CONTINGENT CLAIMS.

We have shown that plaintiff's claims arose after the revesting (pp. 26-29, *supra*). Defendant argues that prior to the revesting the claim relative to the 1943 taxes was contingent and contends that contingent claims must be filed.

Claims not provable in bankruptcy are not discharged. Chapter X (former Sec. 77B) broadened the law with respect to what could be proved, but the matter is one of express statutory provision, and inspection of Chapter X shows that its reference to "executory or contingent claims" relates to claims arising out of contracts of the debtor which were in existence at or before the time the bankruptcy commenced or out of acts of the debtor occurring at or before that time. It does not relate to claims arising from the trustees' acts and unconnected with pre-existing contracts of the debtor. It does not relate to claims which may arise by reason of an enrichment, thereafter occurring, of the party to whom the assets have been returned, merely because the enrichment may in some way have its roots in acts of the trustees.*

*Thus, *City Bank Farmers Trust v. Irving*, 299 U.S. 433, and *Hippodrome Building Co. v. Irving Trust Co.*, 91 F.2d 753, cited by defendant, involved claims by a landlord for injury due to rejection of a lease of the debtor and involved specific provisions of Section 77B treating of leases and dealing with a specific problem which had aroused Congressional atten-

What plaintiff had, prior to the tax settlement of 1947, was not a contingent claim but merely a right to seek declaratory relief with respect to what would be the rights of the parties in the event that tax savings should arise in the future. *Maguire v. Hibernia Savings & Loan Society*, 23 Cal.2d 719 at 734.

A suit for declaratory relief against a Section 77 trustee may be maintained outside the Bankruptcy Court. *Gutensohn v. Kansas City Southern Railway Co.*, 140 F.2d 950 (8 Cir.). *A fortiori*, if a cause of action for coercive relief subsequently arises, a party cannot be held to be barred from presenting it to a federal court in equity merely because he had not presented a request for declaratory relief to the bankruptcy court at a time when he yet had no claim for coercive relief.

E. Reply to Defendant's Argument That There Can Be No Obligation to Plaintiff Because the Trustees Had No Authority to Incur It.

Defendant contends that the obligation here involved accrued before the reorganization was terminated. Defendant then seeks to avoid the fact of its assumption of the trustees' obligation by arguing that the obligation was not that of the trustees because they were not authorized by the court to incur it! (D. Br. 72.) Although plaintiff has been wronged and the defendant enriched, the wrong is to go unremedied and no one is to be held liable!

Defendant's citations refer, at best, only to the enforcement of express contracts.* Whoever voluntarily chooses to enter into a

tion. *American Service Co. v. Henderson*, 120 F.2d 525, and *Foust v. Munson SS Lines*, 299 U.S. 77, pertain to tort claims arising before institution of bankruptcy from personal injuries or from wilful acts of the debtor, not of the trustees. *Guaranty Trust Company v. Henwood*, 86 F.2d 347, involved rights under a pre-existing contract.

*They do not even go that far. In the principal citation, *Chicago Deposit Vault Company v. McNulta*, 153 U.S. 554, the question was as to the binding effect of an unauthorized long term lease for the portion of the term extending beyond the receivership. The court commented (p. 563) that the lessor had been fully paid under the lease for the time "that its premises were occupied for the benefit of the trust" and recognized the right in equity of a party supplying something of value to the receiver to be compensated although there had been neither previous approval nor subsequent

contract with court officers may be bound to ascertain the scope of their authority, on the principle pertaining generally to agents.

But the principle does not apply to non-contractual obligations. No one would think of asserting that, where a receiver is authorized to operate a railroad, the receivership is not liable for personal injuries resulting from negligence, because the court did not authorize the receiver to commit the tort. It is equally absurd to say that a receiver may unilaterally take another's money, property, rights or other thing of value to the enrichment of the estate and yet not subject the enriched estate to liability unless the court had authorized the receiver to incur the liability.

Court officers are held peculiarly bound by obligations arising on principles of quasi-contract and unjust enrichment (O. B. 91). In *Re Hunter*, 151 Fed. 904, an estate in bankruptcy was held liable when the trustee held over to the estate's benefit, after termination of a lease. In *Thompson v. Texas Mexican R. Co.*, 328 U.S. 134, a contract for the use of tracks was cancelled, but Section 77 trustees thereafter operated over the tracks. It was held that suit could be maintained against them by the owner of the tracks for the reasonable value.*

If a trust estate is enriched by the unauthorized acts of the trustee, the estate must account whether the act is an unauthorized contract or a tort (*Restatement of Trusts*, Sec. 269; 2 *Scott on Trusts*, Sec. 269 to 269.2). If a trustee, not empowered to borrow money for the trust, nevertheless does so to pay taxes on trust property and so applies the funds, the estate is liable in equity to the lender (*Restatement*, Sec. 269, Comment a, Illustration 1).

ratification. *Northern Finance Corporation v. Byrnes*, 5 F.2d 11, and *Byrnes v. Missouri National Bank*, 7 F.2d 978, also cited by defendant, were not cases of railroad receiverships and recognize a distinction between such non-railroad cases and railroad receiverships, the receiver in the latter having broader authority.

*Whether the old contract was properly cancelled and the terms on which trackage rights may be acquired were administrative questions for the Interstate Commerce Commission, and the suit was stayed for those issues to be decided, but the court was quite clear as to the consequences otherwise.

A leading case is Judge Cardozo's decision in *Whiting v. Hudson Trust Co.*, 138 N.E. 33; 234 N.Y. 394.*

Similarly, as is stated in 2 *Scott on Trusts*, Section 269.3,

"It seems clear that a person conferring a benefit upon the estate should be permitted to recover against the estate even though the benefit was not conferred as the result of a contract with the trustee or as the result of a tort committed by the trustee. The principle here involved is the ordinary principle applicable to quasi-contractual obligations. If a person confers a benefit upon the trust estate under such circumstances that if the estate were owned by the trustee beneficially he would be entitled to recover in a quasi-contractual action against the trustee personally, he should be entitled to recover out of the trust estate."†

In *Central Trust Co. of New York v. Ohio Central R. Co.*, 23 Fed. 306, where a pooling contract was entered into between two railroads and the profits therefrom were collected and held by the receiver of one, he was required to account to the other, without regard to the validity of the agreement.

Moreover, defendant overstates the rule even in contract cases. While an unauthorized contract may not bind the receivership, it will create a personal liability of the receiver, which courts strictly enforce. *Haines v. Buckeye Wheel Co.*, 224 Fed. 289, 297 (6 Cir.); *In re Erie Lumber Co.*, 150 Fed. 817; 1 *Clark on Receivers*, (2d ed.) p. 527. As said in the Erie case, "It is ever the duty of the court to prevent, if it can, and, if not preventable, to redress so far as the laws permit, injuries inflicted upon others by its officers."

Here it is of no moment whether the liability was that of the trust or of the trustees personally, because by the Assumption

*There are numerous others. Cf. *Alphonzo E. Bell Corp. v. Bell View Oil Syndicate*, 46 C.A.2d 684; 116 P.2d 786.

†Analogously, as stated in 7 *Fletcher's Cyclopedia of Corporations* (Perm. Ed.) 721, Sec. 3579:

"A corporation cannot receive money or property equitably belonging to another and not account for it, even though it was received in connection with an ultra vires contract or act of the corporation. A court of equity * * * will compel an accounting. * * *"

Agreement defendant assumed all liabilities and obligations of the trustees in order that they might personally be exonerated.

Finally, the fact is that the trustees were authorized to do the acts from which the obligation to the plaintiff arose. The court had authorized the trustees to manage and conduct the business of the railroad (1098 D 20). This carried with it authority under *Internal Revenue Code*, Sec. 52 to file income tax returns in defendant's name (O. B. 43). Before filing the 1943 return the trustees had petitioned the court for authority to create the reserve fund (1772 P 58), and on the hearing the trustees' counsel explained the trustees' intention to file consolidated returns and to use the plaintiff's stock loss therein, and defendant's president testified to the facts (2023 D 34). The court then granted the petition (O. B. 27). The trustees were thereby authorized to do what they did and incur the legal and equitable consequences.

F. The Fact That Defendant Was in a Fiduciary Relation to Plaintiff Suffices to Prevent Destruction of Plaintiff's Claims.

Plaintiff's tax affairs were being managed by the agents of defendants and the trustees. None of plaintiff's officers or directors knew of the use of its stock loss except such as were also acting for the trustees. Plaintiff's director, Mr. Schumacher, knew the facts, but he was himself one of the trustees (O. B. 12), and plaintiff cannot be barred by his failure to present a claim against himself. Plaintiff's tax counsel were the very counsel who were acting for the trustees (O. B. 15). Its general counsel was also counsel for them (P. 2A, chart attached to Opening Brief). Even had he had any inkling of what had happened, he would never have been permitted to present a claim against them.*

*As said by the court below on this very subject (1053, 1054):

"The Court: Well, that would have been an adverse interest, wouldn't it? * * *

"I would never let a lawyer appointed in my court in a bankruptcy matter pursue that sort of thing. It is true that the trustees are officers of the court, but they are charged with preserving the res for the benefit of all parties involved, and if somebody asserts some claims that would involve, or have its impact, upon that res, certainly the man that asserts the claim couldn't be represented by the same man who represents the trustee as an officer of the court."

By its acts defendant became a fiduciary to the plaintiff in the premises. It may not now take advantage of its own delinquency toward the plaintiff to retain what does not equitably belong to it.

There is no "sacro-sanctity to bar orders fixing a time limit within which claims against a receiver must be filed," and even in a case where such an order is proper and has been entered, it will succumb to opposing equities. *Wheeling Valley Coal Corporation v. Brady*, 159 F.2d 155 at 159 (4 Cir.). As was there said: "even where an order of this sort is made, it does not follow that its binding effect is greater than needs dictate." (p. 157, quoting *Glenn on Liquidation*, p. 429.)

CONCLUSION

The court below found that the "tax savings" arising through the use of plaintiff's loss was \$17,201,739. We have shown that defendant's use of plaintiff's loss to discharge defendant's tax liability resulted in the unjust enrichment of defendant in that amount and that such enrichment should be paid over to plaintiff.

Defendant has in its possession large reserves held to pay any judgment rendered in this suit—reserves made up out of the very moneys which would have been paid to the United States, had not its taxes been paid by defendant's use of plaintiff's rights (O. B. 27). These reserves should reach their proper destination.*

*In a footnote (D.Br. 82) defendant briefly contends that plaintiff's claim relating to the 1943 taxes is barred by the statute of limitations. No such contention is made relative to 1944 or the claim for refund.

The claim for 1943 taxes is not barred. As noted at pages 26-29, *supra*, the cause of action did not accrue until 1947. This suit, when filed in 1946, was for declaratory relief, preceding the accrual of the cause of action. *Maguire v. Hibernia Savings & Loan Society*, 23 Cal.2d 719, 734; 146 P.2d 673.

If, as defendant contends, the claim arose while the trustees were in possession, defendant assumed it by the Assumption Agreement, the cause accrued as against it on the date of that agreement, December, 1944, and the applicable statute is Cal. Code of Civil Procedure, Section 337(1), prescribing 4 years for an action on a contract in writing. *Sherwood &*

Respectfully submitted,

HERMAN PHLEGER
 MAURICE E. HARRISON
 MOSES LASKY
 BROBECK, PHLEGER & HARRISON
 FRANK C. NICODEMUS, JR.
 A. PERRY OSBORN
 NORRIS DARRELL
 MAHLON DICKERSON
 LEROY R. GOODRICH

*Attorneys for Plaintiffs
 and Appellants.*

Dated: December 22, 1950.

Sherwood v. Gill & Lutz, 36 Cal. App. 707, 173 Pac. 171; *Anderson v. Calaveras Cent. Min. Co.*, 13 C.A.2d 338, 343, 57 P.2d 560.

Even apart from the written assumption, the period would be 4 years under C.C.P., Sec. 343, generally applied to suits in equity (*Sherman v. S.K.D. Oil Company*, 185 Cal. 534, 545, 197 Pac. 799), particularly for an accounting (*Moss v. Moss*, 20 Cal.2d 640, 644, 128 P.2d 526; *McArthur v. Blaisdell*, 159 Cal. 604, 115 Pac. 52; *Austin v. Harry E. Jones*, 30 C.A.2d 362, 368, 86 P.2d 379), which lies to settle the rights and liabilities between all persons standing in fiduciary relations to each other (1 *Pomeroy, Equity Jurisprudence* (5th ed.) Sec. 186(a), pp. 267-8).

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 12506

WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. DUP. BAYARD, Receiver,
Plaintiffs-Appellants,
and

MEREDITH H. METZGER, HENRY OFFERMAN and
J. S. FARLEE & Co., INC.,
Plaintiffs-Intervenors-Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, et al.,
Defendants-Appellees.

REPLY BRIEF FOR PLAINTIFFS-INTERVENORS APPELLANTS

WILLIAM E. HAUDEK,
JULIUS LEVY,
WEBSTER V. CLARK,

Rogers & Clark,
111 Sutter Building, San Francisco 4, Calif.

Pomerantz Levy Schreiber & Haudek,
295 Madison Avenue, New York 17, N. Y.

David Friedenrich,
Balfour Building, San Francisco 4, Calif.

Attorneys for Plaintiffs-Intervenors-Appellants.

TABLE OF CONTENTS

	PAGE
POINT I—Defendant was obligated to deal fairly with plaintiff because of the duality of management and because of defendant's control of the tax transaction	2
A. Contrary to appellees, the fiduciary relation between the parties is highly relevant because it subjected defendant to the strict duty of dealing fairly with plaintiff	2
B. Duality of management and control of the tax transaction by defendant were found by the Court below, are indisputable, and establish defendant's duty to deal fairly with plaintiff in the tax transaction	3
C. Plaintiff owed no fiduciary duty to defendant; but even if it did, defendant nonetheless also owed fiduciary duties to plaintiff	5
POINT II—Fairness required defendant to allow plaintiff all or at least a substantial part of the tax savings	6
A. The purpose of the tax laws was to benefit plaintiff	7
1. The purpose of Internal Revenue Code, § 23(g)(4)	7
2. The purpose of Internal Revenue Code, § 141	7
B. The purpose of the tax laws was foiled by the economic severance of the parties.....	11
C. The alleged twenty years' tax practice of the Western Pacific Group is contrary to fact and, in any event, furnishes no test of what would have been fair after the economic severance of the parties	13

	PAGE
D. The precedents allegedly militating against tax savings payments deal with unified groups of corporations and are therefore inapplicable where, as here, the economic unity has been severed.....	15
1. The Treasury Department	16
2. The alleged "general business practice".....	17
3. The Federal Trade Commission.....	17
4. The Securities and Exchange Commission.....	17
5. The Interstate Commerce Commission.....	17
E. Plaintiff was under no obligation to make its tax credit available to defendant.....	18
F. An agreement by defendant to allow plaintiff a fair share of the tax savings would not have destroyed those savings	21
G. Plaintiff's claim is not inconsistent with defendant's reorganization	22
H. The amount of plaintiff's recovery should be determined in conformance with the purpose of the tax laws	24
POINT III—The defense of bankruptcy bar is unsound because contrary to an express statute and a long line of authorities	25
A. The authorization of the bankruptcy court was not a prerequisite of plaintiff's claim; moreover such authorization was given.....	26
B. To the extent that plaintiff's claim was originally directed against the reorganization trustees, it was validly assumed by the defendant.....	28
C. Plaintiff was, by express statute, relieved from any requirement to present its claim to the bankruptcy court	31

1. The statute would have authorized plaintiff to sue the reorganization trustees without resort to the bankruptcy court..... 32
2. Defendant, having assumed the obligation of the trustees, is equally amenable to suit..... 34
3. The injunctive orders of the bankruptcy court are no obstacle to this action..... 35
4. Appellees' authorities are not in point..... 37

POINT IV—The defenses of res judicata and statute of limitations are without merit..... 39

1. The defense of res judicata..... 39
2. The statute of limitations..... 39

TABLE OF CASES

	PAGE
Alameda Investment Co. v. McLaughlin, 28 F. 2d 81 (D. C., N. D. Cal., 1928), aff'd 33 F. 2d 120 (C. C. A. 9, 1929)	10
Alprosa Watch Corp. v. Commissioner, 11 T. C. 240 (1948)	19
American Brake Shoe & F. Co. v. Pere Marquette R. Co., 263 Fed. 237 (D. C., E. D. Mich., 1920).....	33, 34, 35
Anderson v. Calaveras Central Mining Corp., 13 Cal. App. 2d 338, 57 Pac. 2d 560 (1936).....	39
Atlantic City E. Co. v. Commissioner, 288 U. S. 152 (1933)	9
Blaustein v. Pan American P. & T. Co., 263 App. Div. 97, 31 N. Y. S. 2d 934 (1st Dept., 1941), aff'd 293 N. Y. 281, 56 N. E. 2d 705 (1944).....	5
Bogart v. George K. Porter Co., 193 Cal. 197, 223 Pac. 959 (1924)	39
Bremer v. Chicago & E. I. R. Co., 247 Ill. App. 406 (1927, not otherwise reported).....	34
Byrnes v. Missouri National Bank, 7 F. 2d 978 (C. C. A. 8, 1925)	27
Callaway v. Benton, 336 U. S. 132 (1949).....	18
Case v. Los Angeles Lumber Co., 308 U. S. 106 (1939)	22
Chelrob v. Barrett, 293 N. Y. 442, 57 N. E. 2d 825 (1944)	24
Chicago Deposit Vault Co. v. McNulta, 153 U. S. 554 (1894)	26, 27
Chicago G. W. R. Co. v. Hulbert, 205 Fed. 248 (C. C. A. 8, 1913)	34

Utilities Service Co., Matter of (S. E. C. Holding Company Act Release No. 5535, January 3, 1945, File No. 70-988)	24
Colorado & S. R. Co.. In re, 84 F. Supp. 134 (D. C. Colo., 1949), cert. den. 338 U. S. 847.....	38
Commercial National Bank in Shreveport v. Parsons, 144 F. 2d 231 (C. C. A. 5, 1944).....	11
Consolidated Electric & Gas Co., Matter of, 15 S. E. C. 161 (1943)	11, 24
Consolidated Rock Products Co v. DuBois, 312 U. S. 510 (1941)	5
Cooper v. Central Alloy Steel Corp., 43 Ohio App. 455, 183 N. E. 439 (1931).....	11
Daniels v. Johnson, 129 Cal. 415, 61 Pac. 1107 (1900).....	39
Denver & R. G. R. Co. v. Gunning, 33 Colo. 280, 80 Pac. 727 (1905)	34
Duryee v. Erie R. Co., 175 F. 2d 58 (C. A. 6, 1949), cert. den. 338 U. S. 861.....	38
Ecker v. Western Pacific R. Corp., 318 U. S. 448 (1943)	23
Erie Lumber Co., In re, 150 Fed. 817 (D. C., S. D. Ga., 1906)	27
Ewen v. Peoria & E. R. Co., 78 F. Supp. 312 (S. D. N. Y., 1948), cert. den. 336 U. S. 919.....	6
Gableman v. Peoria D. & E. R. Co., 179 U. S. 335 (1900)	32, 36
Gray v. Grand Trunk W. R. Co., 156 Fed. 736 (C. C. A. 7, 1907)	34
Hanlon v. Smith, 175 Fed. 192 (C. C., N. D. Iowa, 1909)	34
Hawkins v. St. Louis & S. F. R. Co., 202 S. W. 1060 (Mo. App., 1918, not otherwise reported).....	34

	PAGE
Hellier v. Baush M. T. Co., 21 F. 2d 705 (C. C. A. 1, 1927)	4
Hopkins v. Detrick, 97 A. C. A. 55, 217 P. 2d 78 (1950).....	10
Ice Service Co. v. Commissioner, 30 F. 2d 230 (C. C. A. 2, 1929)	9
International Radio Telegraph Co. v. Atlantic Communication Co., 290 Fed. 698 (C. C. A. 2, 1923).....	6
Jacobowitz v. Thomson, 141 F. 2d 72 (C. C. A. 2, 1944)...	32
Kalb & Berger Mfg. Co., In re, 165 Fed. 895 (C. C. A. 2, 1908)	27
Kansas City M. & O. R. Co v. Latham, 182 S. W. 717 (Tex. Civ. App., 1915, not otherwise reported).....	34
Kennison v. Philadelphia & R. C. & I. Co., 38 F. Supp. 980 (D. C., Minn., 1940).....	33, 37
Lassiter v. Norfolk S. R. Co., 163 N. C. 19, 79 S. E. 264 (1913)	34, 35, 36
Lehigh Coal & Nav. Co. v. Central R. Co., 35 N. J. Eq. 426	26
Leiman v. Guttman, 336 U. S. 1 (1949).....	27
McColgan v. Maier Brewing Co., 134 F. 2d 385 (C. C. A. 9, 1943), cert. den. 320 U. S. 737.....	37, 38
McNulta v. Lochridge, 141 U. S. 327 (1898).....	33
Meinhard v. Salmon, 249 N. Y. 458, 164 N. E. 545 (1928)	2
Northern Finance Corp. v. Burns, 5 F. 2d 11 (C. C. A. 8, 1925)	27
Northern Pacific R. Co. v. Boyd, 228 U. S. 482 (1913)...	22
Pepper v. Litton, 308 U. S. 295 (1939).....	3, 5
Phillips-Jones Corp. v. Parmley, 302 U. S. 233 (1937) ..	11

Pressed Steel Car Co. of New Jersey, In re, 100 F. 2d 147 (C. C. A. 3, 1938), cert. den. 306 U. S. 648.....	31
Smith v. Jones L. & M. Co., 200 Fed. 647 (D. C., W. D. Wis., 1912)	36
Southern Pacific Co. v. Bogert, 250 U. S. 483 (1919).....	5
Texas & P. R. Co. v. Johnson, 151 U. S. 81 (1894).....	32, 33
Thompson v. Texas Mexican R. Co., 328 U. S. 134 (1946)	32
Truncale v. Universal Pictures Co., 76 F. Supp. 465 (D. C., S. D. N. Y., 1948).....	11, 20
U. S. v. California & O. L. Co., 192 U. S. 355 (1904).....	39
Wandalia R. Co. v. Keys, 46 Ind. App. 353, 97 N. E. 173 (1910)	34
Wass v. Conron Bros. Co., 59 F. 2d 969 (C. C. A. 2, 1932)	27
Western Pacific R. Co., In re, 124 F. 2d 136 (C. C. A. 9, 1941)	12
Willcox v. Jones, 177 Fed. 870 (C. C. A. 4, 1910).....	33
Ziegler v. Pitney, 139 F. 2d 595 (C. C. A. 2, 1943).....	32

TABLE OF STATUTES AND REGULATIONS

	PAGE
Bankruptcy Act:	
§ 77	32
California Code of Civil Procedure:	
§ 337(1)	40
§ 339(1)	39
Federal Rules of Civil Procedure:	
Rule 52(a)	32
Internal Revenue Code:	
§ 23(g)(4)	7, 11, 21, 22
§ 115	16
§ 115(b)	16
§ 141	8, 11
I. T. 3252 (1939—1 Cum. Bull. 182)	21
I. T. 3637 (1944 Cum. Bull. 258)	16
I. T. 3692 (1944 Cum. Bull. 261)	16
Judicial Code (new), § 959, 28 U. S. C. (new) § 959	31
Judicial Code (old), § 66, 28 U. S. C. (old) § 125, enacted by § 3 of the Act of Mar. 3, 1887 (24 Stat. 554), amended in 1888 (25 Stat. 436) and 1911 (36 Stat. 1104)	31, 32, 34, 36, 38
Public Utility Holding Company Act, § 12, 15 U. S. C.	
§ 791	17
Securities and Exchange Commission, Rule U-45(b)(6)	17
Treasury Regulation 104:	
§ 23.12(b)	28
§ 23.15(a)	19
§ 23.15(d)	16

TABLE OF AUTHORITIES

	PAGE
Collier on Bankruptcy (14th Ed., 1947), § 10.06, pp. 3462-3	33
Cook on Corporations, § 662.....	4
Federal Trade Commission, Summary Report to the Senate of the United States, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.	17
Restatement, Judgments (1942), §§ 47, 48.....	39
Senate Finance Committee, Report, 70th Cong., 1st Sess., S. R. 960 (1928).....	8

United States Court of Appeals

FOR THE NINTH CIRCUIT

WESTERN PACIFIC RAILROAD CORPORATION
and ALEXIS I. DUP. BAYARD, Receiver,
Plaintiffs-Appellants,

and

MEREDITH H. METZGER, HENRY OFFERMAN
and J. S. FARLEE & Co., INC.,
Plaintiffs-Intervenors-Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY,
et al.,
Defendants-Appellees.

No. 12506

REPLY BRIEF FOR PLAINTIFFS-INTERVENORS APPELLANTS

This brief will show, (1) that the arguments on the merits, advanced in defendants-appellees' brief ("DB" hereinafter), are without substance (Points I and II, *infra*); (2) that the alleged defense of bankruptcy bar (DB 68) is contrary to an express statute and to an unbroken line of authorities (Point III, *infra*); and (3) that the defenses of res judicata and statute of limitations—half-heartedly asserted in a footnote (DB 82)—are equally untenable (Point IV, *infra*).

The factual inaccuracies of appellees' brief will be corrected only where necessary in the context of our discussion. Appellees' individual arguments, however repetitious,* will be answered only once. Nor shall we stop to rebut appellees' charge (DB 15) that our main brief is

* Thus the argument based on the alleged tax practice of the Western Pacific group appears not less than fifteen times (DB 7, 12, 15, 18, 19, 22, 30, 37-38, 42 [twice], 52, 58, 59, 63, 65-66).

“replete with erroneous and misleading statements,” since that is refuted by the record.*

On the merits we believe that the case cannot be disposed of by broad generalizations such as that plaintiff has “no standing in court” because its claim does not fit the conventional categories of “tort”, “contract” or “statutory right” (DB 24). The case, as we see it, turns on two questions: Was the relation between the parties such as to subject defendant to the fiduciary duty of dealing fairly with plaintiff? And, if so, did fairness require defendant to allow plaintiff all or at least a substantial share of the tax savings which defendant derived from the use of plaintiff’s tax credit? We turn to answering appellees’ arguments as they bear on these questions.

POINT I

Defendant was obligated to deal fairly with plaintiff because of the duality of management and because of defendant’s control of the tax transaction.

A. Contrary to appellees, the fiduciary relation between the parties is highly relevant because it subjected defendant to the strict duty of dealing fairly with plaintiff.

According to appellees (DB 22), the only question in this case is whether defendant’s use of plaintiff’s tax credit was sufficient, *per se*, to vest a money claim in plaintiff. If not, then, it is said, “arguments about fairness, duality and fiduciary obligations are all irrelevant” (DB 22).

The argument is patently wrong. “Many forms of conduct permissible in a workaday world for those acting at arm’s length, are forbidden to those bound by fiduciary ties”; *Meinhard v. Salmon*, 249 N. Y. 458, 464, 164 N. E.

* Most of appellees’ charges are inconclusive on their face. Thus our statement that Curry was a “chief clerk or office manager”, based on Curry’s testimony (R. 639), is hardly contradicted by the trial judge’s remark that Curry was competent, intelligent and “probably” a pretty good railroad man (DB 15).

45 (1928, Cardozo, J.). Had this defendant been a complete stranger to plaintiff, it would have been free to make self-interest the sole guide of its actions. But if defendant was a fiduciary, it bears the burden "not only to prove the good faith of the transaction, but also to show its inherent fairness"; *Pepper v. Litton*, 308 U. S. 295, 306 (1939). The existence of a fiduciary relation is therefore highly relevant since it establishes fairness as the test by which defendant's conduct in the tax transaction is to be measured.

3. Duality of management and control of the tax transaction by defendant were found by the Court below, are indisputable, and establish defendant's duty to deal fairly with plaintiff in the tax transaction.

1. The findings of the District Court are unambiguous:

"It was there [in the supplementary complaint] further alleged that the defendant through its officers and attorneys had controlled the board of directors of the plaintiff corporation and that by reason of such control plaintiff was caused to file the consolidated returns for the benefit of the defendant. Throughout the proceedings and in the trial, this has been referred to as 'duality of control'."

(R. 264)

"* * * there is a preponderance of the evidence in favor of the plaintiff's contention of 'duality of control'."

(R. 272)

This finding, which appellees neither claim nor show to be clearly erroneous", is binding here; Rule 52(a) F. R. C. P.

2. Appellees nevertheless ignore it. They blandly assert (DB 34) that plaintiff had "control over the tax transactions" because "the returns could not be filed except as they were signed and filed by the Corporation"; so that the final decisions were necessarily made by the Corporation when it filed the returns" (DB 34).

These assertions are contrary not only to the finding of the Court below, but to the record. Plaintiff's board of directors made no "final decisions" because it was never consulted (R. 663-4, 666-7, 1018). And Curry, who signed the returns as plaintiff's president, likewise made no "final decisions" for plaintiff because he was actually a mere chief clerk or office manager (R. 639), in the exclusive pay of defendant (R. 1738), had no understanding of tax matters (R. 808), and signed the returns only because he was told that Polk, defendant's tax counsel, had approved them (R. 664, 666). The truth is that the "final decisions" emanated from defendant, as is shown by the testimony of Mr. Polk, attorney for one of the appellees and called as a witness by appellees:

"Q. Who made the decision [to use the stock loss]?"

A. Mr. Elsey, Mr. DeGraff [i.e., defendant's president and defendant's general auditor, R. 1251, 1408]."

(R. 1448)

"A. The decisions to file the returns were, of course made by the company [i.e., defendant]."

(R. 1450)

3. Given duality of management, which is undisputed and control of the tax transaction by defendant, which was found by the Court below and is established by the record, defendant's duty to deal fairly with plaintiff in the tax transaction follows of necessity. The cases cited in our opening brief ("IntOB" hereinafter), pp. 28-29, so hold; and appellees' authorities confirm the same rule. Thus *Hellier v. Baush M. T. Co.*, 21 F. 2d 705, 707 (C. C. A. 1. 1927), discussing a transaction between two corporations having common directors, quotes from 3 *Cook on Corporations*, § 662:

"If the transaction is fair, the court will sustain it; if it is unfair, the court will undo it."

We submit, therefore, that fairness is the standard by which the tax transaction between plaintiff and defendant must be judged.

Plaintiff owed no fiduciary duty to defendant; but even if it did, defendant nonetheless also owed fiduciary duties to plaintiff.

In an attempt to exonerate defendant from any fiduciary duties to plaintiff, appellees argue that, on the contrary, plaintiff, as the holding company, was the fiduciary of defendant, its subsidiary (DB 30-32, 41, 66). But this argument has already been answered (IntOB 66, 67); and it is indeed untenable.

1. A holding corporation as such is not a fiduciary of its subsidiary; *Blaustein v. Pan American P. & T. Co.*, 163 App. Div. 97, 119, 31 N. Y. S. 2d 934, 956 (1st Dept., 1941), aff'd 293 N. Y. 281, 56 N. E. 2d 705 (1944). It becomes a fiduciary only by controlling the subsidiary's affairs. "It is the fact of control * * * that creates the fiduciary obligation"; *Southern Pacific Co. v. Bogert*, 250 U. S. 483, 492 (1919). Appellees' thrice-cited authority, *Consolidated Rock Products Co. v. DuBois*, 312 U. S. 510, 522 (1941), stands for the same proposition, as appears from the court's language, omitted from appellees' quotation (DB 31).*

During the critical period plaintiff had no vestige of control over defendant. Up to December 31, 1944, defendant was in the hands of its court-appointed reorganization trustees; after that date, the reorganized defendant was owned and controlled by its new stockholders. Appellees do not claim that plaintiff dominated the trustees or the new management of defendant. Their argument that plaintiff was a fiduciary of defendant is therefore without basis.

* The Supreme Court's complete language reads (312 U. S., at 522):

"But equity will not permit a holding company, *which has dominated and controlled its subsidiaries*, to escape or reduce its liability to those subsidiaries by reliance upon self-serving contracts which it has imposed on them. A holding company, *as well as others in dominating and controlling positions* (*Pepper v. Litton*, 308 U. S. 295), has fiduciary duties to security holders of its system which will be strictly enforced."

Appellees' quotation (DB 31) omits the language here italicized.

2. It is also irrelevant. Even if it were assumed *arguendo*, that plaintiff was under fiduciary obligations to defendant, defendant was certainly likewise subject to fiduciary duties to plaintiff. Mutual fiduciary duties are not uncommon in the law, as in the case of partners or joint venturers. If it were thought that the present parties owed fiduciary obligations to each other, the result would still be the duty to deal fairly; and that is all we contend for.

Appellees' other arguments pertaining to duality—such as the alleged absence of secrecy (DB 32-33), the alleged creation of duality by plaintiff (DB 36), and the alleged inapplicability of the duality rule to reorganization trustees and their employees (DB 37)—have been dealt with in our opening brief (IntOB 32-35). Since appellees do not undertake to answer what we there said, it need not be repeated here.

We proceed, therefore, to discuss what the requirements of fairness were in the tax transaction between these parties.

POINT II

Fairness required defendant to allow plaintiff all or at least a substantial part of the tax savings.

Although appellees contend (DB 38) that "fairness" is too vague a standard by which to judge defendant's conduct, it is the customary and time-proved test; *Ewen v. Peoria & E. R. Co.*, 78 F. Supp. 312, 316 (S. D. N. Y. 1948, L. Hand, C. J.), cert. den. 336 U. S. 919. Guidance for its application is found in appellees' own authorities for they hold that, when the fairness of a transaction between fiduciary and cestui is in issue, the touchstone is "whether the proposition submitted would have commended itself to an independent corporation"; *Ewen* case, *ibid.*, quoting from *International Radio Telegraph Co. v. Atlantic Communication Co.*, 290 Fed. 698, 702 (C. C. A. 2, 1923).

Had plaintiff been an "independent corporation", under a management wholeheartedly devoted to its sole interest, it would have found literally nothing to commend this transaction by which plaintiff conferred a \$17,000,000 tax benefit on defendant without receiving any benefit whatever. Corporations are not organized to distribute largesse to strangers. An independent management of plaintiff, competent and well advised, would have considered that plaintiff's tax credit was allowed by law in order to mitigate its stock loss, not to give a tax windfall to the prosperous defendant; that plaintiff might have opportunities to use the tax credit for its own benefit; that, by joining in consolidated returns, plaintiff would subject itself to liability for any tax deficiencies of defendant; that defendant, economically a total stranger to plaintiff, was anxious to obtain the benefit of plaintiff's tax credit; and that plaintiff was under no obligation to surrender it to defendant. Under these circumstances the proposition that plaintiff surrender its tax credit to defendant without assurance of a fair share in the resultant savings, was utterly unfair and plaintiff would have been fully justified in rejecting it.

None of appellees' arguments can shake this conclusion.

A. The purpose of the tax laws was to benefit plaintiff.

1. *The purpose of Internal Revenue Code, § 23(g)(4):* This section allowed plaintiff a tax credit for the loss of its \$75,000,000 stock investment in defendant. We have shown (IntOB 38-39) that the provision was intended for plaintiff's benefit in order to mitigate its loss. Appellees' silence on this point indicates that they do not dispute this proposition.

2. *The purpose of Internal Revenue Code, § 141:* This section permits the filing of consolidated tax returns by an affiliated group of corporations. We have shown (IntOB 39-42) that the provision was intended for the benefit of the parent corporation of the group. In an

economic sense the parent, in effect, owns the assets of all group members; their profits and losses are actually the profits and losses of the parent; the right to offset such profits and losses is thus granted for the parent's benefit and any incidental tax savings of a subsidiary redound to the benefit of the parent by the automatic operation of economic factors, i.e., the increased value of the parent's stock in the subsidiary or the payment of dividends.

Appellees consider this a "singularly unsophisticated" view of holding company systems (DB 50, 61-63). Consolidated returns may be filed, according to appellees' twice-repeated but nevertheless incorrect paraphrase of the statute, "whenever 95 per cent of the voting stock is within the system" (DB 50, 61-62).^{*} Subsidiaries, even though thus affiliated with a holding company, frequently have senior securities (preferred stock, notes and bonds) outstanding with the public. It follows, say appellees, that holding company systems filing consolidated returns are not ordinarily "single ownerships" (DB 50) and that their "economic unity" is "a false factor demonstrably of no significance" (DB 61).

But our position, however unsophisticated, happens to be that of Congress, of the Treasury Department, of the Supreme Court, and of other courts analyzing the rationale of consolidated returns. Thus the *Report of the Senate Finance Committee*, 70th Cong., 1st Sess. S. R. 960, p. 14 (1928):

"Much of the apprehension about consolidated returns will be removed when it is realized that *it is only when the corporations are really but one corporation that the permission to file consolidated returns is given*, and that no ultimate advantage under the tax laws really results. The present law permits the filing of consolidated returns only where one corpora-

^{*} Actually § 141(d) requires also 95% ownership of nonvoting stock, except such as is "limited and preferred as to dividends". Contrary to appellees' contention (DB 50), the 95% requirement applies therefore to all equity stock, voting or nonvoting.

tion owns at least 95 per cent of the stock of the other corporation or if at least 95 per cent of the stock of both corporations is owned by the same interest. The provision embodies the business man's conception of a practical state of facts." (Italics added)

Congress, concededly familiar with the subsidiaries' practice of issuing senior securities to the public (DB 50), thus considered, nevertheless, the ownership of 95% of their equity stock sufficient to constitute parent and subsidiary as "really but one corporation". Congress thus recognized the "economic unity" of parent and subsidiary as the legislative justification of consolidated returns.*

So did the Treasury Department and the Supreme Court. In *Atlantic City E. Co. v. Commissioner*, 288 U. S. 152, 154 (1933), the Supreme Court stated:

"The requirement of consolidated returns was 'based upon the principle of levying the tax according to the true net income and invested capital of a *single business enterprise*, even though the business is operated through more than one corporation.' Treasury Regulations No. 45, Art. 631." (Italics added)

The reference by the Treasury Department and the Supreme Court to the "single business enterprise operated through more than one corporation" as furnishing the basis for consolidated returns confirms that these authorities, too, conceived holding company systems filing consolidated returns as "single ownerships" or "economic units"—the very proposition which appellees would like to reject.

Reference may finally be made to *Ice Service Co. v. Commissioner*, 30 F. 2d 230, 231 (C. C. A. 2, 1929):

"The theory of affiliation resulting in a consolidated return for taxes is that the income and invested capital are really the income and capital of a single enterprise,

* Appellees' argument that the economic unity of an affiliated group is destroyed if a subsidiary has mortgage bonds outstanding, would mean, in effect, that even a single corporation, part of whose property is mortgaged, is no longer an economic unit. That is hardly "the business man's conception of a practical state of facts."

though carried on through the instrumentality of several corporations. [Citing authorities.] Only when the outside interest—that is, the interest of the minority—is so small as to be practically negligible are the two corporations to be treated as in receipt of a single income, requiring a consolidated return.”

Consolidated returns are thus permitted because the income and losses of the subsidiaries are, in an economic sense, the income and losses of the parent. As the common owner of the enterprise, the parent suffers from the losses sustained by any member of the affiliated group; and the parent is the ultimate and intended beneficiary of any tax savings which any group member derives from the filing of consolidated returns.* “The benefit of the statute extends to him on whom is the hazard of the several enterprises”, i.e., the parent; *Alameda Investment Co. v. McLaughlin*, 28 F. 2d 81, 82 (D. C., N. D. Cal., 1928), *aff’d* 33 F. 2d 120 (C. C. A. 9, 1929).

Appellees’ analogy of this case to *Hopkins v. Detrick*, 97 A. C. A. 55, 217 P. 2d 78 (1950), is misplaced. The court there denied a husband’s claim to tax refunds which might be payable to his wife. But the court’s opinion does not disclose the basis of the claim or the nature of the tax refunds; the reference to “saved” taxes, although quoted by appellees (DB 44), is not in the opinion. Nor does it appear that the wife had utilized a tax credit belonging to the husband or that, by filing joint returns reporting her earnings as community property, she had breached a fiduciary duty to her husband, or that a tax statute intended for the husband’s benefit was involved. Appellees’

* Appellees say (DB 63) that the automatic upstream flow of the subsidiary’s tax savings to the parent will not take place if the subsidiary’s bonds are in default, its debenture interest unpaid, preferred stock in arrears or general creditors unsatisfied. But, actually, any tax saving of the subsidiary will reduce these senior charges and thus improve the value of the parent’s equity stock in the subsidiary, unless and until an approved reorganization plan of the subsidiary cuts off the parent’s interest in the assets and earnings of the subsidiary—which is the case at bar.

other authority, *Cooper v. Central Alloy Steel Corp.*, 43 Ohio App. 455, 183 N. E. 439, 444 (1931), has nothing in common with this case except isolated phrases which appellees cite out of context.

B. The purpose of the tax laws was foiled by the economic severance of the parties.

The Supreme Court's decision of March 15, 1943, affirming defendant's reorganization plan, eliminated plaintiff's stock interest in defendant and thereby cut off the automatic upstream flow to plaintiff of any tax savings which defendant thereafter might derive from the filing of consolidated returns and the use of plaintiff's tax credit. Under these circumstances, defendant's retention of all the tax savings and the denial of any share therein to plaintiff were contrary to the purpose of both I. R. C. § 23(g)(4) and § 141 and hence unfair to plaintiff.*

1. Appellees claim (DB 60) that the Supreme Court severed nothing, but merely rendered the severance probable. But appellees themselves gave the answer in Polk's letter to the Internal Revenue Department, dated May 31, 1946 (Pl. Ex. 64, R. 1779), which concludes that plaintiff's stock in defendant

“at all times, until the date of the Supreme Court decision March 15, 1943, had a real and material fair market value, and that the stock became worthless on or after March 15, 1943 * * * ”

(R. 1783)

* Appellees say that “the revenue acts create no private rights” (DB 48). We agree. But under general law, tax transactions may give rise to a multitude of private rights, such as contribution, *Phillips-Jones Corp. v. Parmley*, 302 U. S. 233 (1937), or accounting, *Truncale v. Universal Pictures Co.*, 76 F. Supp. 465 (D. C., S. D. N. Y., 1948), *Commercial National Bank in Shreveport v. Parsons*, 144 F. 2d 231 (C. C. A. 5, 1944), or contract, *Matter of Consolidated Electric & Gas Co.*, 15 S. E. C. 161 (1943).

Even much earlier the lawyers had advised that:

“The stock of the Western Pacific Railroad Company should be written down to \$1 as of the date of the Supreme Court decision approving the I. C. C. plan of reorganization * * * wherein the stock is declared worthless.”

(R. 561-2)

In any event, appellees concede and, indeed, proclaim that “the returns were proper under the tax laws” (DB 18). This means that defendant’s stock became “completely worthless” (DB 39) in 1943; and it is not too important whether that happened on March 15 or some other date in 1943. Certainly the economic unity was severed when the returns were filed in 1944 and 1945. Appellees’ denial that the Supreme Court’s decision severed the economic unity is thus not only contrary to fact, but irrelevant.

2. It is also inconsistent with appellees’ other argument, namely, that the economic unity of the Western Pacific group had ceased long before March 15, 1943 (DB 60-61). Appellees’ latter contention is as untenable as their first. As pointed out in Polk’s letter already mentioned, defendant’s reorganization plan had been reversed by this Court on November 28, 1941 (*In re Western Pac. R. Co.*, 124 F. 2d 136) because of the Commission’s and the District Court’s failure to make findings which would justify the elimination of plaintiff’s stock interest in defendant (R. 1781). This Court’s decision thus “was a practical assurance of participation in the reorganization by the equity ownership”, i.e., plaintiff (R. 1782). Only after this Court’s decision was in turn reversed by the Supreme Court on March 15, 1943, were the worthlessness of plaintiff’s stock in defendant and the severance of economic unity established facts.

From this time on, we submit, the purpose of the tax laws—to mitigate plaintiff’s loss and to benefit it as the parent of the affiliated group—could be accomplished only by an arrangement between plaintiff and defendant allowing plaintiff all or at least a substantial share of the tax savings.

C. The alleged twenty years' tax practice of the Western Pacific group is contrary to fact and, in any event, furnishes no test of what would have been fair after the economic severance of the parties.

Appellees' argument (DB 59, 65) runs: During the years prior to 1943 plaintiff, defendant and their affiliates had consistently filed consolidated tax returns. The taxes paid by plaintiff pursuant to such returns were allocated among the various affiliates having taxable income in proportion to the amount of such incomes. Affiliates who contributed a loss and thereby reduced the consolidated tax are said to have received no payment for contributing their loss. Such having been the practice before 1942, appellees say it would have been unfair for plaintiff to demand a change in 1943 and thereafter, when such change would be to plaintiff's advantage.

The argument does not stand analysis.

1. It is factually unsound. During the years from 1918 to 1924, one of the affiliates joining with plaintiff and defendant in consolidated returns did make substantial "tax savings payments" to plaintiff, as is more fully demonstrated in the footnote.*

* The affiliate was the Utah Fuel Company. The facts appear from a Price, Waterhouse report (Def. Ex. 40). Page references in this footnote refer to said Defendants' Exhibit 40.

In the interest of brevity, we confine ourselves to the taxes for the year 1923, other years being similar. In 1923 the separate income of Utah Fuel Company (including its subsidiaries) was \$1,053,957.73 (pp. 6, 13). At the then prevailing 12½% tax rate, the income tax payable by Utah Fuel Company, on a separate basis, would have been \$131,744.72.

Utah Fuel Company however joined with plaintiff and the other members of the Western Pacific group in a consolidated tax return. Plaintiff had sustained a substantial loss in 1923 (p. 13). The total consolidated tax amounted therefore to only \$71,268.88 (p. 13); and the proportionate share of Utah Fuel Company in the consolidated tax would have been only a fraction of this \$71,268.88.

But actually the benefit of this tax reduction was not passed on to Utah Fuel Company. On the contrary, Utah Fuel Company

2. Appellees' argument also ignores their other contention that the pre-reorganization defendant and its reorganization trustees were altogether "distinct entities" (DB 2). The pre-reorganization practice of plaintiff and defendant certainly could not pre-judge what should be done as between plaintiff and the trustees. During the reorganization years 1936 to 1941 neither plaintiff nor defendant's trustees had taxable income (Def. Exs. 46, 47, R. 2040-1), so that no tax problem could arise. And when defendant's trustees for the first time realized income in 1942, they felt so little bound by the previous tax practice that they retained tax counsel to obtain their advice on the "very critical question" of whether consolidated or separate returns should be filed (Pl. Exs. 39-B, 39-D, R. 544, 546).

3. In any case, the tax practice of the Western Pacific group in earlier years is totally irrelevant to the events of 1943 and thereafter. The \$593,976.33 tax savings which plaintiff is said to have derived by filing consolidated returns (DB 59, 65), accrued during the period from 1924 to 1935 (DB 65; R. 2040). During this period, the Western Pacific group was an economic unit; tax savings payments would have been unnecessary and pointless since all tax savings automatically redounded to the benefit of plaintiff, the common parent. Thus, if plaintiff sustained a loss and one of its subsidiaries profited, the tax saving of the subsidiary became automatically the tax saving of the parent, so that the formality of a tax saving payment was superfluous. Conversely, if plaintiff had a profit and one

paid the full sum of \$131,744.72 (p. 6), i.e., the tax it would have had to pay on a separate basis. It paid

to the Government:	\$71,268.88
to plaintiff:	\$60,475.84 (p. 6)

Total paid by Utah Fuel Co.: \$131,744.72 (p. 6)

This transaction is thus a clear instance of a "tax savings payment" and refutes appellees' contention that consolidated taxes were apportioned among the income companies of the Western Pacific Group in the proportion of their respective incomes.

of its subsidiaries a loss, a tax saving payment by the parent to the subsidiary would have been as meaningless as it would be for an individual to shift money from one pocket to another. So long as the Western Pacific group constituted an economic unit, there was no reason or purpose for making tax savings payments.

But the situation was quite different when, on March 15, 1943, the economic unity of plaintiff and defendant was severed. From that time on, the automatic upstream flow of defendant's tax savings was interrupted. The tax savings of defendant were no longer the tax savings of plaintiff. Hence it was at this point, and not before, that an adjustment of tax savings between defendant and plaintiff became important and necessary.

We submit that the alleged absence of tax savings payments during the period before 1943—when such payments would have been unnecessary and meaningless—furnishes no test for the years 1943 and thereafter when the usefulness and significance of such payments first arose.

D. The precedents allegedly militating against tax savings payments deal with unified groups of corporations and are therefore inapplicable where, as here, the economic unity has been severed.

Appellees contend (DB 52-58) that it is the "general business practice" of affiliated groups to allocate the consolidated tax to the income companies of the group, without any allowance to loss companies; that various administrative agencies (the Treasury, the F. T. C., the S. E. C., the I. C. C.) have advocated this practice; and that therefore fairness did not require defendant to allow plaintiff a share of its tax savings.

The principal trouble with this argument is that the so-called precedents dealt with the normal situation of a consolidated return filed by an economically unified group of corporations; whereas the very basis of our claim lies in the economic severance of the parties. None of appellees' precedents deals with such a situation; none is therefore here pertinent.

But appellees' arguments are unsound for additional reasons.

1. *The Treasury Department.* Appellees' argument postulates a rigid rule requiring that tax savings arising from consolidated returns must be allocated to the income companies of the group in proportion to their incomes, without any allowance to the loss companies. But the simple fact is that no such requirement exists. On the contrary, Treas. Reg. 104, § 23.15(d) expressly recognizes the freedom of the group members to agree on such allocation of the tax burden as they see fit (IntOB 50-51).

Appellees (DB 56) invoke certain Treasury rulings—I. T. 3637 and I. T. 3692 (DB App. 17, 21)—as supporting their position. But these rulings deal with a specific narrow problem not here pertinent; * and the rulings carefully emphasize that:

“The [Internal Revenue] Bureau is not concerned with arrangements made between affiliated companies as to the payment of the [consolidated] tax. * * * As a matter of fact one of the affiliates may make all of the tax payments via the parent corporation, * * *”

I. T. 3637 (1944 Cum. Bull. 258; DB App. 20)

Nothing in the Treasury Regulations prevented therefore these parties from arranging for a fair division of the tax savings.

* Internal Revenue Code, § 115 defines “dividends” as payments made by a corporation to its shareholders “out of its earnings or profits”. Once a corporation has earnings or profits available for the distribution of dividends, then a distribution made by the corporation to its shareholders will be deemed a “dividend” to the extent of the available earnings or profits (§ 115 (b)).

This statute made it necessary to define the concept of “earnings or profits available for dividends” in situations where consolidated tax returns are filed. I. T. 3637 and I. T. 3692 furnish that definition. But these rulings do not pre-judge the right of affiliated companies to make such tax allocations *inter sese* as they may see fit.

2. *The alleged "general business practice"* does not exist. The Western Pacific group itself deviated from it (*supra*, p.); and the Report of the Federal Trade Commission * (DB App. 2) enumerates many instances of tax savings payments which were approved by the appropriate state regulatory commissions (see DB App. 2-3).

3. *The Federal Trade Commission.* It is true, as appellees say (DB 50, 57), that the F. T. C. criticized tax savings payments and recommended the enactment of legislation absolutely forbidding them (DB App. 6). But, as we have shown (IntOB 52), the recommendation was limited to the field of public utilities; and, in any case, it was not adopted by Congress. The F. T. C.'s Report, and expressions based thereon such as those of Senator Wheeler (DB 51), are therefore not indicative of Congressional policy. Congress, instead of adopting the rigid prohibition proposed by the F. T. C., left the matter for regulation by the S. E. C.; Public Utility Holding Company Act, § 12, 15 U. S. C., § 79l.

4. *The Securities and Exchange Commission*, pursuant to this Congressional authorization, adopted its Rule U-45(b)(6) which we have extensively discussed (IntOB 44-49). The Rule, as we have shown, is not mandatory, but flexible; while stating the normal rule of proportional allocation, it allows exceptions; and, in the exercise of this latitude, the S. E. C. has repeatedly permitted tax saving payments to be made to loss companies where required in the interest of fairness (see cases cited IntOB 45, 46, 49).

5. *The Interstate Commerce Commission.* Appellees admit (DB 58) that the I. C. C. has not dealt with the prob-

* *Federal Trade Commission, Summary Report to the Senate of the United States*, pursuant to Senate Resolution No. 83, 70th Cong., 1st Sess., on Economic, Financial and Corporate Phases of Holding and Operating Companies of Electric and Gas Utilities, Part 72-A, Sen. Doc. No. 92, 70th Cong., 1st Sess.

lem of the allocation of consolidated taxes. The two I. C. C. decisions cited by appellees (DB 58) bear no relation to the issues at bar.

E. Plaintiff was under no obligation to make its tax credit available to defendant.

Appellees reiterate with great insistence that plaintiff was obligated to minimize defendant's taxes by making its tax credit available to defendant (DB 32, 40, 41, 59, 66). They invoke two grounds: Plaintiff, they say, was a fiduciary of defendant (but see *supra*, pp. 5-6); and the Bankruptcy Act obligated plaintiff, as stockholder, to preserve defendant's assets. Both arguments have been answered in our opening brief (pp. 66-68). Here we confine ourselves to certain supplementary observations.

1. Appellees say that the bankruptcy court could and would have compelled plaintiff to join in consolidated returns (DB 40-41). But apart from the jurisdictional impossibility of such action, *Callaway v. Benton*, 336 U. S. 132, 141-9 (1949),* the argument begs the question: The bankruptcy court, or any other court of equity, would have exercised such compulsion only if plaintiff had been under an obligation to file consolidated returns. The existence of that obligation cannot be proved by speculations as to what action the bankruptcy court might have taken.

2. Had plaintiff enjoyed taxable income of its own, it could have used its tax credit to minimize its own taxes. In that case no one would dream to argue that plaintiff was under a duty to surrender its tax credit to defendant. No clearer proof is possible that the tax credit was a valu-

* Appellees would distinguish this case on the ground that the present plaintiff had become a party to defendant's reorganization (DB 41). But plaintiff was permitted to intervene in defendant's reorganization because it was "an unsecured creditor and the sole stockholder of" defendant (R. 1994); it thus submitted itself to the bankruptcy court's jurisdiction with respect to its own claims against the debtor, not with respect to any claims the debtor might assert against it.

able right of plaintiff which it was not obligated to give away. The fact that plaintiff actually had no income of its own does not affect its rights; for the owner's inability to use his property gives no right to others to appropriate it.

3. Appellees say that it "cost the Corporation nothing" to surrender its tax credit to defendant (DB 32). Even if that were true, it would not follow that defendant had a right to appropriate plaintiff's tax credit or that plaintiff was obligated to surrender it. But appellees' premise is wrong:

(a) To begin with, plaintiff's joining in consolidated returns subjected it to liability for any tax deficiency of defendant; Treas. Reg. 104, § 23.15(a) (IntOB App. 12). It would seem preposterous to suggest that plaintiff was obligated to make itself the surety of defendant's undetermined tax obligations.

(b) The value of plaintiff's tax credit must be determined as of the time defendant appropriated it, i.e., July 15, 1944 (the date of the 1943 returns). At that time plaintiff had a real possibility of utilizing its tax credit to its own direct benefit. The fact that plaintiff's tax credit could be carried forward as far as 1945, could have been utilized to attract new capital investments in plaintiff; and plaintiff, with such new financing, could have enjoyed the benefit of its tax credit. See *Alprosa Watch Corp. v. Commissioner*, 11 T. C. 240 (1948), the facts of which are set forth in the footnote.* Plaintiff's management, devoted

* The taxpayer in the *Alprosa Watch* case was a corporation engaged in the business of manufacturing and selling gloves under the name of "Esspi Glove Corporation". It sustained a substantial loss in its operations. The stockholders of the corporation thereupon sold their stock to a new group. The new stockholders changed the name of the taxpayer to "Alprosa Watch Corporation", moved its business to new quarters and caused the corporation to give up the glove business and to engage in the business of purchasing and selling jewelry. The Tax Court held that the corporation could use the loss sustained in its glove business as a tax credit against the profits made in its jewelry business.

solely to the interests of defendant, entertained no such thoughts; but that does not change the fact that plaintiff's tax credit could have been the instrument of breathing new life into plaintiff. It was therefore an asset of real and substantial value; and the contention that its surrender to defendant cost plaintiff nothing is plainly wrong.

(c) Apart from all these considerations, plaintiff's tax credit was a valuable asset because defendant needed it and was in a position to derive benefits from it. The tax credit thus had "a 'sale' value of which the ceiling is the amount of such benefits" as defendant could realize therefrom; *Truncale v. Universal Pictures Co.*, 76 F. Supp. 465, 469 (D. C., S. D. N. Y., 1948). This point has been more fully developed in our opening brief (pp. 56-57); appellees have not answered what we there said; and their attempted distinction of the *Truncale* case (DB 45-46) has no bearing on its aspect here involved.

4. Appellees argue (DB 40) that it would have been wrong for plaintiff "to require payment for the service of signing a paper" (i.e., the consolidated returns); that "a reorganization court pays nothing for nuisance value"; and that plaintiff would not have been permitted to drive "a hard bargain" with the trustees.

The argument completely misconceives the nature of our case. We never contended that plaintiff was entitled to payment for its signature. We did and do contend that the tax credit was plaintiff's; that it was created by law to mitigate plaintiff's stock loss; that, before surrendering its tax credit to defendant, plaintiff was therefore entitled to demand an appropriate share of the resulting tax savings of defendant; that this demand would have been fair because consonant with the purpose of the tax laws; and that, because of the duality of management, defendant was required to deal fairly with plaintiff. Appellees' attempt to characterize our postulate as a nuisance bargain is far off the mark indeed.

F. An agreement by defendant to allow plaintiff a fair share of the tax savings would not have destroyed those savings.

Appellees argue (DB 39) that an agreement allowing plaintiff a share of the tax savings would have destroyed the savings themselves. For the possibility of using plaintiff's stock loss as a tax deduction depended upon the stock's becoming *completely* worthless; and, say appellees, if plaintiff received a tax benefit from its stock loss, that very fact would have demonstrated that the stock still had some value to plaintiff.

The argument borders on the absurd.

(a) If appellees were right, no stock loss could ever be used as a tax deduction. For, according to appellees, the tax deduction flowing from the stock loss would demonstrate that the stock was not yet completely worthless; and hence the tax deduction would have to be disallowed. Such circular reasoning would, of course, defeat the very purpose of I. R. C., § 23(g)(4), to mitigate a stock loss by allowing it as a tax deduction.

By the same token, if plaintiff had been permitted a share in the tax savings resulting from its stock loss, the stock would nevertheless have been completely worthless, since the payment would have been made not for the stock, but for the use of the tax credit.

(b) Appellees (DB 39) invoke a Treasury ruling, I. T. 3252 (1939-1 Cum. Bull. 182). The taxpayer there had made an executory contract for the sale of certain stock. The stock thereafter became worthless, but the taxpayer was still entitled to receive the purchase price. The taxpayer's claim for a tax deduction on the ground that the stock had become worthless was disallowed—necessarily so since the depreciation of the stock did not affect the taxpayer. No analogy flows from this case to ours, where the complete worthlessness of defendant's stock held by plaintiff was indisputable.

G. Plaintiff's claim is not inconsistent with defendant's reorganization.

Appellees argue (DB 59, 66) that, in defendant's reorganization, its secured creditors were not paid in full; that plaintiff, as stockholder of defendant, ranked behind the secured creditors; that, under the absolute priority rule of the *Boyd* case,* plaintiff could receive nothing until its seniors were paid in full; and that the allowance of plaintiff's present claim would violate this principle.

This reasoning is, in essence, the same as that of the Court below which held that the allowance of plaintiff's claim would be contrary to defendant's reorganization plan (R. 272-4). It has been answered in our opening brief (pp. 64-65).

1. The absolute priority rule requires that stockholders shall not participate in a corporate reorganization so long as senior claimants are not satisfied in full. This principle was meticulously followed in defendant's reorganization; defendant's stock held by plaintiff was completely wiped out. Indeed, the complete worthlessness of plaintiff's stockholdings in defendant was the basis upon which plaintiff became entitled to a tax credit under I. R. C., § 23(g)(4).

But once this elimination of the old stock in defendant was accomplished, the operation of the absolute priority rule was at an end. Certainly the rule does not require the denial of claims arising *during reorganization* solely because the claimant happens to be a stockholder!

To illustrate: Suppose that a railroad, in the hands of reorganization trustees, negligently injures one of its passengers. Would it be argued that the passenger's claim for damages must be rejected because he happens to be a stockholder of the railroad and his stock is without equity? The answer would obviously be no; and it would be equally negative if the victim of the railroad's negligence should happen to be the owner of all its stock. The injured pas-

* *Northern Pacific R. Co. v. Boyd*, 228 U. S. 482 (1913); *Case v. Los Angeles Lumber Co.*, 308 U. S. 106 (1939).

senger's claim for damages could not be defeated because his stock ranks junior to the secured creditors; or because, as the holder of all of the stock, he is claimed to be a fiduciary; or because, under the Bankruptcy Act, he is required to preserve the assets of the railroad.

The present case is not different. Plaintiff's stockholdings in defendant were eliminated in conformity with the priority rule. But after this was done, defendant used plaintiff's tax credit. This gave rise to a new claim on plaintiff's part—not for the recognition of its stock interest in defendant, but for the use of its tax credit. It is therefore idle to contend that the assertion of this claim is contrary to the principle of priority or to the reorganization plan's purpose to eliminate plaintiff's stockholdings in defendant.

2. Appellees argue *ad misericordiam* that plaintiff's claim would "undermine the financial position" of defendant (DB 42). But actually it would leave defendant where the bankruptcy courts intended to place it and where defendant itself and its security holders counted on being placed. When the Supreme Court passed on defendant's reorganization plan, the junior interests demanded consideration because of defendant's "unexpectedly large earnings"; *Ecker v. Western Pacific R. Corp.*, 318 U. S. 448, at 508 (1943). In answer the Supreme Court referred to the "effect of taxation" which was "more likely to affect net earnings" (*ibid.*). Defendant's new capitalization was thus based on the assumption that it would have to pay the normal taxes; and of this fact defendant gave warning to the world by setting aside a \$10,000,000 tax reserve. Defendant has now succeeded in avoiding these taxes. Its security holders thereby obtained a windfall which the Supreme Court never contemplated giving them. But the windfall came from the use of plaintiff's tax credit. To say, under these circumstances, that plaintiff's claim to a fair share in this windfall would "deplete the assets" of defendant (DB 66) is little less than a parody on the facts.

H. The amount of plaintiff's recovery should be determined in conformance with the purpose of the tax laws.

Our briefs, we believe, have shown that plaintiff's treatment by defendant—the denial to plaintiff of any and all benefit from the tax transaction—was clearly unfair. It remains to consider the amount of relief that will cure the wrong. Fairness again must be the guidepost.

1. In determining the requirements of fairness, the Court will not, as appellees suggest, try to “make a retrospective bargain” (DB 39). The courtroom is not the market place. Once a transaction between fiduciary and cestui is recognized as unfair, the consequences follow as a matter of law.* The superior negotiating skill of one party, the economic weakness of the other may fashion the terms of a deal between parties transacting at arm's length. But these factors are of no account in the judicial award of what is fair; objective standards, such as those applied in *Chelrob v. Barrett*, 293 N. Y. 442, 57 N. E. 2d 825 (1944), control.

2. It is our primary contention that plaintiff is entitled to the full amount of the tax savings. That follows from the purpose of the tax laws to confer a tax benefit on plaintiff, not on defendant. In cases comparable to ours, this solution was held to be fair. *Matter of Consolidated Electric & Gas Co.*, 15 S. E. C. 161 (1943); *Matter of Cities Service Co.* (S. E. C. Holding Company Act Release No. 5535, January 3, 1945, File No. 70-988, discussed IntOB 46). But should the Court find some equity in defendant's having contributed to the achievement of the savings, then, we submit, fairness dictates that plaintiff is entitled to at least half of the savings which the use of its tax credit made possible.

* Appellees' argument that “the reorganization trustees [of defendant] are not parties to this proceeding” (DB 39) is beside the point since defendant has by contract assumed all obligations of the trustees (R. 78, 1712-3; *infra*, p. 28).

POINT III

The defense of bankruptcy bar is unsound because contrary to an express statute and a long line of authorities.

Appellees contend (DB 68) that plaintiff's claim, even though originally valid, was barred by plaintiff's failure to have it approved by the bankruptcy court. Payment of plaintiff's claim, it is said, would have been an expense of reorganization; the bankruptcy court, according to appellees, had exclusive jurisdiction to pass on the claim; and plaintiff failed to present it to the only competent forum (DB 68).

Before answering this argument, it is necessary to deal with two preliminary points. For intermingled with their argument just mentioned, appellees present two others: That the reorganization trustees, against whom the claim was originally directed, did not have the necessary authority from the bankruptcy court to incur such liability (DB 72-74); and that, in any event, the liability is that of the trustees and was never assumed by defendant (DB 20, 75-79). Since these two contentions are not strictly germane to the defense of bankruptcy bar, we shall dispose of them in advance before turning to appellees' main argument.

Accordingly, we shall show under this pointhead that:

1. The authorization of the bankruptcy court was not a prerequisite of plaintiff's claim; moreover, such authorization was given (A, *infra*);

2. To the extent that plaintiff's claim was originally directed against the reorganization trustees, it was validly assumed by defendant (B, *infra*); and

3. Plaintiff was, by express statute, relieved from any requirement to present its claim to the bankruptcy court (C, *infra*).

A. The authorization of the bankruptcy court was not a prerequisite of plaintiff's claim; moreover such authorization was given.

Appellees argue (DB 72-74) that a reorganization trustee cannot validly incur any liability without approval of the court. Here the bankruptcy court directed that "any extraordinary expense" was to be "subject to the prior approval of the Court" (R. 1910, 1929). The liability to plaintiff, it is said, was an "extraordinary expense" and did not have prior court approval.

There are many difficulties with this argument.

1. The consolidated returns for 1944 and the refund claim for 1942 were both filed in 1945 (Pl. Exs. 5, 6), long after defendant had emerged from reorganization on December 29, 1944 (R. 499). The trustees had, therefore, nothing to do with these transactions, so that the rule requiring court approval of their liabilities could not come into play.

2. The rule was also inapplicable to the returns for 1943. The doctrine that reorganization trustees cannot incur liabilities without court approval is limited to *contract obligations*; see *Chicago Deposit Vault Co. v. McNulta*, 153 U. S. 554, 562 (1894).^{*} A trustee who in the conduct of the debtor's business violates the anti-trust laws, or engages in unfair competition, or appropriates the property of another, cannot escape liability by saying that his incurring any of these liabilities was an "extraordinary expense" not authorized by the court. Each of the authorities cited by

^{*} The Supreme Court, quoting from *Lehigh Coal & Nav. Co. v. Central R. Co.*, 35 N. J. Eq. 426, held

" * * * he [the receiver] has no authority to bind the trust by *contract* without the authority of the court. Until his contracts are approved and ratified by the court the court is at liberty to deal with them as to it shall appear just, and may either modify them or disregard them entirely * * *."

"This states the correct rule upon the subject * * *"

(153 U. S., at 562; italics added)

appellees (DB 72, 74) involved express contract obligations arising, e.g., from a lease *, from a loan of money,** from the purchase of goods,*** or from a retainer agreement.† The present claim is based on a breach of fiduciary duty and is therefore non-contractual.

3. The present claim is not an "extraordinary expense". The filing of tax returns is an ordinary and necessary incident of running a railroad. Appellees themselves proclaim that "these tax transactions were handled in the ordinary course of business" (DB 12) and were carried on in a "routine" fashion (DB 21). The mere fact that the expense is large does not render it "extraordinary".

4. If court approval were deemed necessary, it is found in the bankruptcy court's order of March 3, 1944 (Def. Ex. 12, R. 1895). By this order the court, having been notified of the trustees' intention to file consolidated returns for 1943 and to use plaintiff's stock loss (R. 1271-2, 2025), authorized the creation of a tax reserve in connection with these returns. While the bankruptcy court did not pass on the propriety of the proposed tax transactions, it certainly cannot be argued that what the trustees did was beyond the scope of their authority. It follows that they and the estate administered by them became liable for the consequences of their conduct; *Vass v. Conron Bros. Co.*, 59 F. 2d 969, 970 (C. C. A. 2, 1932).

5. But even if it were assumed, *arguendo*, that the trustees exceeded their authority, they would still have incurred personal liability; *In re Kalb & Berger Mfg. Co.*, 165 Fed. 895, 896 (C. C. A. 2, 1908). Such liability was

* *Chicago Deposit Vault Co. v. McNulta*, 153 U. S. 554 (1894).

** *Northern Finance Corp. v. Byrnes*, 5 F. 2d 11 (C. C. A. 8, 1925); *Byrnes v. Missouri National Bank*, 7 F. 2d 978 (C. C. A. 8, 1925).

*** *In re Erie Lumber Co.*, 150 Fed. 817 (D. C., S. D. Ga., 1906).

† *Leiman v. Guttman*, 336 U. S. 1 (1949).

covered by defendant's assumption agreement, to be presently discussed, since, as appellees admit, that agreement was couched in broad language "in order to give the trustees full protection against personal liabilities" (DB 76). We submit that an obligation of the trustees for the 1943 tax savings is indisputable.

B. To the extent that plaintiff's claim was originally directed against the reorganization trustees, it was validly assumed by the defendant.

Appellees contend that the tax savings were those of the trustees (DB 1, 6, 20); that plaintiff's claim is therefore directed against the trustees; and that defendant did not assume this liability of the trustees (DB 20, 75-79).

This argument, like that just discussed, can apply only to the taxes for 1943. As we have shown, the returns for 1944 and the refund claim for 1942 were filed after defendant had emerged from reorganization; the trustees had therefore nothing to do with these tax transactions; and the liability arising therefrom was, from the very outset, that of defendant.

We agree, however, with appellees that the returns for 1943 were filed while the trustees were still in charge, and were consented to by the trustees as required by Treas. Reg. 104, § 23.12(b) (IntOB App. 11). The liability to plaintiff arising from this transaction was therefore originally that of the trustees. But defendant, by a clear and unequivocal contract, approved by the bankruptcy court, assumed this liability.

1. Toward the end of 1944, defendant was ready to come out of reorganization. Accordingly, the bankruptcy court made its so-called revesting order of November 27, 1944 (Pl. Ex. 14, R. 1711, 36-108), by which it directed the trustees to return the properties in their hands to defendant, and directed defendant to assume certain liabilities and obligations of the trustees. Paragraph 8(a) of the revesting order (R. 46) prescribed and approved spe-

cifically the terms of the assumption agreement to be executed by defendant (R. 76-81). Pursuant to this direction, the assumption agreement was executed by defendant on December 14, 1944 (Pl. Ex. 15, R. 1711, 76).

So far as here pertinent, the assumption agreement provides that

“the undersigned [i.e., defendant] does hereby:

* * * * *

“2. Assume any and all outstanding current liabilities and obligations incurred by said Trustees and without limitation thereto, any and all liabilities or obligations of the debtor in possession or said Trustees with respect to claims for personal injury or death, for loss or damage to property and generally any and all liabilities and obligations with respect to claims of any character whether heretofore or hereafter asserted arising out of the possession, use or operation of the debtor’s properties by said Trustees, or their conduct of the debtor’s business, including liabilities and obligations hereafter arising up to midnight December 31, 1944.”

(R. 78, 1712-1713)

The assumption agreement thus included “any and all liabilities and obligations with respect to claims of any character * * * arising out of the possession, use or operation of the debtor’s properties by said Trustees, or their conduct of the debtor’s business”. The language could not have been broader. It requires no elaboration that plaintiff’s claim arose from the trustees’ “conduct of the debtor’s business”, since the filing of tax returns was a necessary incident of the conduct of the debtor’s business. Indeed, appellees do not contend otherwise.

(It should be added that defendant also assumed all federal tax liabilities of the trustees, R. 1716.)

2. Appellees contend, nevertheless, that the assumption agreement did not embrace the present claim. But their arguments cannot prevail against the clear language of the agreement.

(a) In the first place, appellees say that the agreement applied only to "recognized debts" (DB 76). But the agreement contains no such qualification; on the contrary, it covers claims "heretofore or hereafter asserted". If, for instance, a negligence claim arose against the trustees on the day before the agreement was signed, it did not constitute a recognized debt; still it was clearly assumed by defendant.

(b) Appellants say next that the agreement did not eliminate the necessity that expenses of administration be approved by the bankruptcy court (DB 76). But that is a different problem, to be dealt with below (C, *infra*, p. 31); it relates to the method of enforcing the claim and has nothing to do with the breadth of the assumption agreement.

(c) Appellants further say that the assumption agreement did not embrace *all* obligations of the trustees because the revesting order described the agreement as covering "certain obligations" of the trustees, only those "valid and outstanding". But the obligation here asserted was a valid one; and the phrase "certain" was justified because defendant assumed only those obligations of the trustees arising from their conduct of the debtor's business and only those incurred up to December 31, 1944.

(d) Appellees next refer to plaintiff's "failure to obtain court approval of their claim" (DB 77). That argument has been answered (A, *supra*, p. 26).

(e) Appellees finally refer to a provision of the reorganization plan stating that defendant was to assume the "current liabilities and obligations incurred by the trustees". The pertinence of this provision does not appear since our claim is not based on the terms of the reorganization plan, but on the assumption agreement as approved by the bankruptcy court's revesting order.

Even if it were assumed, *arguendo*, that defendant assumed only the "current liabilities and obligations" of the trustees, the present claim would still be covered. For

appellees themselves contend that the claim constituted an "expense of administration" (DB 68); and "if it is an expense of administration, it fits within the category of the current liabilities of the receivers referred to as payable [by the reorganized debtor] in the plan of reorganization", *In re Pressed Steel Car Co. of New Jersey*, 100 F. 2d 147, 150 (C. C. A. 3, 1938), cert. den. 306 U. S. 548.*

Plaintiff's claim for the 1943 tax savings was therefore clearly covered by defendant's assumption agreement of December 14, 1944.

C. Plaintiff was, by express statute, relieved from any requirement to present its claim to the bankruptcy court.

Appellees' contention that the bankruptcy court was the exclusive forum to determine plaintiff's claim to the 1943 tax savings **—because the claim was an expense of administration—is contrary to § 66 of the (old) Judicial Code, 28 U. S. C. § 125 (old),*** which provides:

"Every receiver or manager of any property appointed by any court of the United States may be sued in respect of any act or transaction of his in carrying on the business connected with such property, without the previous leave of the court in which such receiver or manager was appointed; but such suit shall be subject to the general equity jurisdiction of the court

* The term "current liabilities" has different meanings, depending on the context in which it is used, as appears from the different definitions cited by appellees (DB 78, fn. 54). None of appellees' authorities dealt with the term "current liabilities" as used in the assumption clause of a reorganization plan; whereas the *Pressed Steel Car* case, *supra*, deals with that very problem.

** Plaintiff's other claims arose in 1945, after defendant had emerged from reorganization, and are therefore not expenses of administration.

*** The statute was enacted by § 3 of the Act of March 3, 1887 (24 Stat. 554), amended in 1888 (25 Stat. 436) and 1911 (36 Stat. 1104). Since September 1, 1948, the section has been replaced by § 959 of the (new) Judicial Code, 28 U. S. C. § 959 (new).

in which such manager or receiver was appointed so far as the same may be necessary to the ends of justice."

This statute applies to the reorganization trustees of a railroad appointed under § 77 of the Bankruptcy Act; *Thompson v. Texas Mexican R. Co.*, 328 U. S. 134, 138 (1946); *Jacobowitz v. Thomson*, 141 F. 2d 72, 75 (C. C. A. 2, 1944); *Ziegler v. Pitney*, 139 F. 2d 595, 596 (C. C. A. 2, 1943).

We shall demonstrate that the statute would have authorized plaintiff to sue defendant's reorganization trustees without resort to the bankruptcy court, regardless of whether the claim was an "expense of administration"; that defendant, having assumed the obligations of the trustees, is equally amenable to suit; and that, under the statute, the injunctive orders of the bankruptcy court, invoked by appellees (DB 79-82), are no obstacle to this action.

1. *The statute would have authorized plaintiff to sue the reorganization trustees without resort to the bankruptcy court.*

"This act [i.e., Judicial Code, § 66] abrogated the rule that a receiver could not be sued without leave of the court appointing him, and gave the citizen the unconditional right to bring his action in the local courts * * *. He ceased to be compelled to litigate * * * in any other forum * * * than he would be entitled to if the property or business were not being administered by the Federal court."

Gableman v. Peoria, D. & E. R. Co., 179 U. S. 335, 338 (1900).

"Necessarily, such suit may be brought in any court of competent jurisdiction and proceed to judgment accordingly."

Texas & P. R. Co. v. Johnson, 151 U. S. 81, 101 (1894).

The qualifying clause of the statute—that the suit shall be subject to the general equity jurisdiction of the appointing court—does not restrict the plaintiff's right to sue the trustees or receiver outside the bankruptcy court; for “the right to sue without resorting to the appointing court * * * cannot be assumed to have been rendered practically valueless by this further provision in the same section of the statute which granted it”; *Johnson* case, *supra*, 151 U. S., at 103. The qualifying clause of the statute relates only to “the mode of enforcing such claim when judicially determined and liquidated”; *American Brake Shoe & F. Co. v. Pere Marquette R. Co.*, 263 Fed. 237, 240 (D. C., E. D. Mich., 1920), citing authorities; *Kennison v. Philadelphia & R. C. & I. Co.*, 38 F. Supp. 980, 983 (D. C., Minn., 1940); see *Willcox v. Jones*, 177 Fed. 870, 874-5 (C. C. A. 4, 1910).

Nearly all claims which fall under § 66 constitute “expenses of administration”; certainly “tort claims arising by virtue of the business operations of the debtor” come within that classification, 6 *Collier on Bankruptcy* (14th Ed., 1947), § 10.06, pp. 3462-3. Nevertheless their assertion outside the bankruptcy court is a matter of indisputable statutory right, established by the authorities cited and many others.

In the present case the trustees operated defendant's railroad properties pursuant to an order of the bankruptcy court (Def. Exs. 20, 22, R. 1908, 1923). Their liability arose from a transaction of theirs in carrying on this business, since their or their agents' act * in causing plaintiff to file consolidated returns and in joining therein was an incident of that business. It follows that plaintiff could have sued the trustees “in any court of competent jurisdiction”, without leave from, or resort to, the bankruptcy court.

* The statutory language, permitting suit against the receiver “in respect of any act or transaction of his”, includes the acts and transactions of his agents; *McNulta v. Lochridge*, 141 U. S. 327, 331 (1891).

2. *Defendant, having assumed the obligation of the trustees, is equally amenable to suit.* A plaintiff who is authorized, by statute, to sue a court-appointed trustee in a forum other than the bankruptcy court appointing him, must *a fortiori* have the same freedom when suing a private corporation which has assumed the obligations of the trustee. It is unthinkable that a bankruptcy court, which is unable to shield its own officers from suits in another forum under § 66, should have power to prevent like suits against the debtor which has emerged from reorganization and assumed the liabilities of the trustees. It is equally unthinkable that the bankruptcy court's jurisdiction, which was non-exclusive during the reorganization, should become exclusive when the reorganization ends.

The courts unanimously agree with our position :

Chicago G. W. R. Co. v. Hulbert, 205 Fed. 248, 250-1 (C. C. A. 8, 1913) ;

American Brake Shoe & F. Co. v. Pere Marquette R. Co., 263 Fed. 237, 240 (D. C., E. D. Mich., 1920) ;

Gray v. Grand Trunk W. R. Co., 156 Fed. 736 (C. C. A. 7, 1907) ;

Hanlon v. Smith, 175 Fed. 192 (C. C., N. D. Iowa, 1909) ;

Lassiter v. Norfolk S. R. Co., 163 N. C. 19, 21-22, 79 S. E. 264 (1913) ;

Denver & R. G. R. Co. v. Gunning, 33 Colo. 280, 292-3, 80 Pac. 727 (1905) ;

Hawkins v. St. Louis & S. F. R. Co., 202 S. W. 1060, 1063-4 (Mo. App., 1918, not otherwise reported) ;

Bremer v. Chicago & E. I. R. Co., 247 Ill. App. 406, 413 (1927, not otherwise reported) ;

Vandalia R. Co. v. Keys, 46 Ind. App. 353, 366-7, 97 N. E. 173 (1910) ;

Kansas City, M. & O. R. Co. v. Latham, 182 S. W. 717, 720 (Tex. Civ. App., 1915, not otherwise reported).

In each of these cases the receiver or trustee of a railroad had, in the conduct of the railroad's business, incurred liability to the plaintiff; upon consummation of the receivership (mostly by foreclosure sale), the reorganized railroad assumed the liabilities of the receiver; the plaintiff sued the reorganized railroad without leave from the bankruptcy court and without having his claim approved by the bankruptcy court. In each case the action was sustained.

" * * * the terms of the statute just quoted [i.e., Judicial Code, § 66] are now as fairly applicable to said petitioner [i.e., the reorganized railroad] as they would have been to the receivers whom they have succeeded, if the latter had not been discharged and, they, instead of petitioner, had been sued in respect of the alleged negligence of their servants in the suit which is the subject of this controversy. This suit was properly brought in the State court, and the latter has full jurisdiction to determine all of the issues involved therein without interference by this court [i.e., the bankruptcy court]. *Texas & Pacific Railway Co. v. Johnson*, 151 U. S. 81; [citing numerous additional authorities]."

American Brake Shoe case, supra, 263 Fed., at 240.

"Inasmuch as an action can be brought in the State court against the receivers in the Federal court, without obtaining permission of that court (U. S. Compiled Statutes, 721(3), Act 3 March 1887, ch. 373, sec. 3), *a fortiori* an action can be brought in the State court against the purchaser, after confirmation of the sale and delivery of the property to such purchaser, without permission of the Federal court."

Lassiter case, supra, 163 N. C., at 21-22.

These cases are on all fours with that at bar. Plaintiff may therefore maintain this action against defendant without previous approval of its claim by the bankruptcy court.

3. *The injunctive orders of the bankruptcy court are no obstacle to this action.* Appellees (DB 79-82) invoke cer-

tain clauses of the bankruptcy court's revesting order of November 27, 1944 (R. 51-52, 59-60, 62) and of its final order of March 28, 1946 (R. 2017-8) on the theory that they bar this action. But they do nothing of the kind.

In the first place, the bankruptcy court had no power to enjoin or bar the bringing of suits authorized by Judicial Code, § 66. "It is entirely clear from the Gableman case. [*supra*, 179 U. S. 335], and many other decisions in the Circuit Courts of Appeals and Circuit Courts, that no power exists in this court to restrain or stay receiver suits in the state courts"; *Smith v. Jones L. & M. Co.*, 200 Fed. 647, 650 (D. C., W. D. Wis., 1912). In the *Lassiter* case, *supra* (163 N. C. 19), the receivership court had reserved "exclusive jurisdiction of this case * * * for the purpose of enforcing all the obligations and rights assumed by said grantee". Nevertheless, an action brought in the state court against the grantee railroad, based on the liability of the receiver, was sustained:

"We do not understand that the right which the plaintiff has under the Federal and State statutes to bring this action in the State Court can be impaired by this decree of the Federal court, nor do we think that such decree was intended to have such effect."

All of the cases cited, *supra*, p. 34, involved injunctive provisions similar to, or even stronger than those at bar. Nevertheless, the actions were permitted to go to judgment.

However, the injunctive orders in the present case, even if they were considered wholly apart from § 66, would not bar the present suit. Thus the revesting order provided that defendant's assets were to be "free and clear" of the rights of any persons, "except as is otherwise provided in this order" (R. 51-52); and it was otherwise provided by that part of the order directing defendant to execute the assumption agreement.

The revesting order also contained the customary blanket injunction restraining all persons from "disturbing" de-

defendant's assets or properties "by reason of or growing out of any obligation or obligations heretofore incurred by the debtor or the debtor's Trustees herein" (R. 59-60). Obviously this sweeping language was not intended to nullify the assumption agreement which had been authorized by another clause of the same order; hence the injunction must be construed as qualified by the assumption agreement. A similar restrictive interpretation of a blanket injunction is found in *Kennison v. Philadelphia & R. C. & P. Co.*, *supra*, 38 F. Supp., at 982-3.

Nor can appellees derive comfort from the blanket injunction of the final order of March 28, 1946, which was qualified by the phrase, "except as specifically provided for or permitted by prior order of this Court" (R. 2017-8). Such "prior order" was the revesting order which had sanctioned defendant's assumption agreement.

We submit, therefore, that the bankruptcy court did not have the power and did not purport to enjoin or bar the prosecution of this action.

4. *Appellee's authorities are not in point.* Appellees' principal reliance (DB 74) is on *McColgan v. Maier Brewing Co.*, 134 F. 2d 385 (C. C. A. 9, 1943), cert. den. 320 U. S. 737, which held that state franchise taxes, accrued against a corporation's bankruptcy receiver but not presented to the bankruptcy court, were discharged by the approval of a plan of composition; the corporation, having emerged from the receivership, was held not to be bound to pay these taxes. The simple reason is that the corporation, otherwise than the present defendant, did not assume the liabilities of the receiver:

"Upon confirmation of the plan for composing of the debts of the Maier Brewing Company, the receiver was discharged and the property *unconditionally* turned back to the corporation. Does the property so returned remain liable for debts incurred by the receiver in the course of administration? We understand not, *unless the court has so directed.*"

(134 F. 2d, at 387; italics added)

Here the court has "so directed" by ordering defendant to execute the assumption agreement. An additional distinction of the *McColgan* case is that the receiver's franchise tax liability did not arise from an "act or transaction of his" within Judicial Code, § 66; that statute, of such importance here, is therefore not even mentioned in the *McColgan* opinion.

Like reasons distinguish this case from *Duryee v. Erie R. Co.*, 175 F. 2d 58 (C. A. 6, 1949), cert. den. 338 U. S. 861, and from *In re Colorado & S. R. Co.*, 84 F. Supp. 134 (D. C. Colo., 1949), cert. den. 338 U. S. 847. Indeed, the liabilities there asserted were not those of a receiver or trustee, but had arisen prior to reorganization (175 F. 2d, at 59) and were therefore provable claims (84 F. Supp., at 145), not within the purview of § 66. And in neither of the two cases did the reorganized debtor execute an assumption agreement.

Appellees preface their arguments with certain generalizations of doubtful accuracy. They assert that "the reorganization court must consider and pass upon all possible claims which might be asserted against the reorganized company" (DB 69). This is true of provable claims; it is not true of trustees' liabilities under § 66. Appellees also proclaim that "the reorganization must put an end to all outstanding claims" (DB 70). This is simply not so where, as here, outstanding claims are provided for by what appellees themselves (DB 76) describe as the "conventional" device of an assumption agreement.

It is therefore submitted that the defense of bankruptcy bar is without merit and should be rejected.

POINT IV

The defenses of res judicata and Statute of Limitations are without merit.

These defenses, set forth in a footnote of appellees' brief (p. 82), are on their face untenable.

1. *The defense of res judicata* is based on appellees' statement that "a litigant who asserts claims against an estate in the hands of the court must in the first proceeding assert all of his claims or be forever foreclosed" (DB 82). However, *res judicata* applies only where the cause of action in the second suit is the same as in the first; *Restatement, Judgments* (1942), §§ 47, 48. Such identity existed in the cases cited by appellees, as is shown by the statement that "The parties, the subject-matter and the relief sought, all were the same"; *U. S. v. California & O. L. Co.*, 192 U. S. 355, 358 (1904). The present plaintiff's demand that its stock interest be recognized in defendant's reorganization was certainly not the same as its claim in the case at bar to a share in defendant's tax savings.

2. *The Statute of Limitations* is said to bar plaintiff's claim to the 1943 tax savings, because the 1943 returns were filed on July 15, 1944, more than two years before the commencement of this action on October 10, 1946 (Calif. Code Civ. Proc., § 339(1)). However, the cause of action which accrued on July 15, 1944 was directed against the trustees. Defendant's liability rests on its assumption agreement of December 14, 1944. On that date—less than two years before the commencement of this action—a new statutory period began to run with respect to plaintiff's cause of action against defendant. *Bogart v. George K. Porter Co.*, 193 Cal. 197, 202, 223 Pac. 959 (1924); *Ander-son v. Calaveras Central Mining Corp.*, 13 Cal. App. 2d 338, 345, 57 Pac. 2d 560 (1936); *Daniels v. Johnson*, 129

Cal. 415, 61 Pac. 1107 (1900). Since the assumption agreement was a written contract within the purview of Calif. Code Civ. Proc., § 337(1), the statutory period for plaintiff's claim, based on that agreement, was four years, and had clearly not expired when this action was commenced.

Respectfully submitted,

ROGERS & CLARK,
POMERANTZ LEVY SCHREIBER & HAUDEK,
DAVID FRIEDENRICH,
Attorneys for Plaintiffs-Intervenors-
Appellants.

WILLIAM E. HAUDEK,
JULIUS LEVY,
WEBSTER V. CLARK,
of Counsel.

No. 12,506

IN THE

United States
Court of Appeals

For the Ninth Circuit

WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. DUP. BAYARD, RECEIVER,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER SOUTH-
ERN RAILWAY, DEEP CREEK RAILROAD COM-
PANY, THE WESTERN REALTY COMPANY, THE
STANDARD REALTY AND DEVELOPMENT COM-
PANY and DELTA FINANCE CO., LTD.,

Appellees.

Petition for Leave to File a Motion to Vacate Order
Striking Appellant's Petition for Rehearing
En Banc and Reinstating Such Petition

HERMAN PHLEGER,
MOSES LASKY,
BROBECK, PHLEGER & HARRISON,
111 Sutter Street, San Francisco 4, Calif.

FRANK C. NICODEMUS, JR.,
44 Wall Street, New York 5, N. Y.

NORRIS DARRELL,
44 Wall Street, New York 5, N. Y.

MAHLON DICKERSON,
120 Broadway, New York 5, N. Y.

LE ROY R. GOODRICH,
Central Bank Bldg., Oakland, Calif.

*Attorneys for Appellant The West-
ern Pacific Railroad Corporation.*

HERMAN PHLEGER,
MOSES LASKY,
BROBECK, PHLEGER & HARRISON,
111 Sutter Street, San Francisco 4, Calif.

*Attorneys for Appellant Alexis I.
duP. Bayard, Receiver.*

SUBJECT INDEX

	Page
Summary	2
Authorities	2
Argument	3
Procedure of Striking Petitions.....	4
Legislative History of Title 28 U.S.C., Sec. 46(c).....	6
Hearing En Banc Particularly Appropriate in This Case.....	7
Conclusion	8
Appendices:	
Appendix 1 (order striking petition for rehearing en banc)....	App. 1
Appendix 2 (Judge Fee's opinion suggesting a rehearing en banc of all Circuit Judges).....	App. 1, 2
Appendix 3 (proposed motion).....	App. 3, 4

INDEX OF AUTHORITIES

TABLE OF CASES

	Pages
Commercial National Bank in Shreveport v. Parson, 144 F.2d 231..	7
Commercial National Bank in Shreveport v. Connolly, 176 F.2d 1004	7
Commercial National Bank in Shreveport v. Connolly, 177 F.2d 514	5
Commissioner v. Textile Mills Corporation, 117 F.2d 62.....	6
Connolly v. Commercial National Bank in Shreveport, 189 F.2d 608	7
Freuhauf Trailer Co. v. Myers, 181 F.2d 1008.....	4
George A. Fuller Co. v. Commissioner, 92 F.2d 72.....	7
Independence Lead Mines Co. v. Kingsbury, 175 F.2d 983.....	3, 4
Kronberg v. Hale, 181 F.2d 767.....	3, 4, 5
Lang's Estate v. Commissioner, 97 F.2d 867.....	6
Northwestern Mutual Life Ins. Co. of Milwaukee v. Gilbert, 182 F.2d 256.....	4
Textile Mills v. Commissioner, 314 U.S. 326.....	2, 3
United States ex rel. Robinson v. Johnston, 316 U.S. 649.....	2, 5
United States v. Sentinel Fire Ins. Co., 178 F.2d 217.....	5

STATUTES AND RULES

Judicial Code, Sec. 46(c).....	2, 3, 6
Rules of Civil Procedure, Section 7(b) (1).....	6
S. 1053, 77th Congress, 1st Sess., a bill to amend Section 212 of old Title 28 U.S.C.....	6, 7
United States Code:	
Title 28, Section 46(c).....	5, 6, 8
Title 28, Section 212.....	6

TEXTS AND MISCELLANEOUS

Final Report of the Committee on Codification and Revision of the Judicial Code	6
Harvard Law Review, Vol. 63, p. 1449.....	3, 4

IN THE

United States Court of Appeals

For the Ninth Circuit

WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. DUP. BAYARD, RECEIVER,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER SOUTH-
ERN RAILWAY, DEEP CREEK RAILROAD COM-
PANY, THE WESTERN REALTY COMPANY, THE
STANDARD REALTY AND DEVELOPMENT COM-
PANY and DELTA FINANCE CO., LTD.,

Appellees.

Petition for Leave to File a Motion to Vacate Order Striking Appellant's Petition for Rehearing En Banc and Reinstating Such Petition

*To the Honorable William Denman, Chief Judge, and to the
Judges of the United States Court of Appeals for the Ninth
Circuit:*

The petition of appellants Western Pacific Railroad Corpora-
tion and Alexis I. duP. Bayard, Receiver, respectfully shows:

On January 30, 1952, this Court (Healy, Circuit Judge, Fee
and Byrne, District Judges) entered an order striking the appel-
lants' petition for rehearing en banc as being without authority in
law or in the rules or practice of the court. A copy is attached as
Appendix I.

On February 18, 1952, Judge Fee filed a dissenting opinion and
suggested a rehearing en banc of all the Circuit Judges. A copy
is attached as Appendix II.

Note: Emphasis is supplied unless otherwise noted.

This petition asks leave to file a motion to vacate the above order and to reinstate the petition for consideration and action by the court. A copy of the motion is attached hereto as Appendix III.

SUMMARY

In striking appellant's petition for rehearing en banc, two judges foreclosed consideration thereof by the members of the court.

This is a direct holding that no litigant is entitled to petition for a rehearing en banc, and that such a petition is to receive no consideration whatever.

It is submitted that this action is without support in law, and that a litigant is entitled under the law to (1) file such a petition, and (2) have it considered and acted upon by the court.

AUTHORITIES

Section 46(c) of the Judicial Code, enacted in 1948, provides:

"(c) Cases and controversies shall be heard and determined by a court or division of not more than three judges, *unless a hearing or rehearing before the court en banc is ordered by a majority of the circuit judges of the circuit who are in active service.* A court en banc shall consist of all active circuit judges of the circuit."

According to the reviser's note, this section "preserves the interpretation established by the *Textile Mills* case", i.e., *Textile Mills v. Commissioner*, 314 U.S. 326.

In *United States ex rel. Robinson v. Johnston*, 316 U.S. 649 (1941), the Supreme Court granted certiorari to this Court, and at the same time vacated this Court's judgment and remanded this case

"for further proceedings, *including leave to petitioner to apply for a hearing before the court en banc.*"

citing the *Textile Mills* case.

This is a direct recognition of the right of a litigant to apply for a rehearing en banc.

We have been unable to find any authority for the proposition that a litigant may not apply for a hearing en banc, or that a court may strike a petition therefor, save *Kronberg v. Hale*, 181 F.2d 767, decided by this Court and cited here as authority for the action taken. Although certiorari was applied for and denied in that case, an examination of the moving papers discloses that this point was not raised.

ARGUMENT

This Court consists of all of the judges thereof (*Textile Mills v. Commissioner*, 314 U.S. 326), and it may sit en banc. Section 46(c) of the Judicial Code provides in terms that it may rehear cases en banc if "ordered by a majority of the circuit judges who are in active service."

If hearings en banc can only be had when ordered by a majority of the circuit judges who are in active service, it follows that a litigant is entitled to have the matter presented to such judges for consideration and action, and that a petition therefor cannot be stricken nor can it be denied by a panel consisting of one circuit judge and two district judges.

In *Independence Lead Mines Co. v. Kingsbury*, 175 F.2d 983 (1949), where a petition for rehearing en banc was denied by this Court, Chief Judge Denman, dissenting, stated (p. 992):

"The attempt of two judges in a panel of three judges to deny a petition for rehearing en banc violates the law as established in *United States ex rel Robinson v. Johnston*, 316 U.S. 649, 650, 62 S.Ct. 1301, 86 L.Ed. 1732, and *Textile Mills Securities Corp. v. Commissioner*, 314 U.S. 326, 333 et seq., 62 S.Ct. 272, 86 L.Ed. 249.

* * * * *

"In view of the Supreme Court decisions cited above, it is too obvious to need argument that two judges cannot thus assume to act on a petition addressed to seven judges."

The *Independence* case was followed by a note on the subject in 63 *Harvard Law Review* 1449. Speaking of that case, it is there said (1451):

"Indeed, since the three judges here could not under § 46 have ordered a rehearing, their action in considering the petition seems singular."

In the same note, the following appears (1450):

"Although it is perhaps impossible to have fixed and detailed criteria for the selection of the cases to be heard *en banc*, fuller development of the rules governing the procedure by which the hearings are granted or denied seems both necessary and practicable. * * * *perhaps formal petition of counsel, as in the instant case, is the most suitable method for initiating a hearing en banc in a particular case.* See Hearings before Subcommittee on Judiciary on S. 1053, 77th Cong., 1st Sess. 16, 40 (1941). * * * Section 46(c) merely provides that the court *may sit en banc* if a majority vote to do so * * * (only four out of nine justices enough, generally, to grant certiorari) * * * *The petition should, it seems, be entitled to such consideration that denial of the petition results only when a majority of the individual judges are unwilling to grant it.*"

PROCEDURE OF STRIKING PETITIONS

The procedure of two judges denying a petition addressed to the whole court seems not to have been repeated in this Court after the *Independence Lead Mines* case. Instead, in *Kronberg v. Hale*, 181 F.2d 767 (Feb. 1950), this Court (per curiam, before Judges Healy, Orr and McAllister) inaugurated the procedure of striking a petition for rehearing *en banc* "as being without authority in law or in the rules or practice of the court".

Twice in May of the same year an identical order was made on the authority of the *Kronberg* case by a panel consisting of Circuit Judge Bone and District Judges Goodman and Mathes. *Freuhauf Trailer Co. v. Myers*, 181 F.2d 1008, and *Northwestern Mutual Life Insurance Co. of Milwaukee v. Gilbert*, 182 F.2d 256.

The order in the instant cause, striking the petition for rehearing *en banc*, cites *Kronberg v. Hale* as authority. The order was that of but two judges, one circuit judge and one district judge.

We respectfully submit that the practice inaugurated in *Kronberg v. Hale* and followed in this case, i.e., striking the petition for rehearing en banc by the order of a majority of the court which heard the case, is not supported in law, or the rules of this Court and that it is not justified under the statute authorizing and recognizing rehearings en banc.

The statement that a petition for rehearing en banc is "without authority in law" is contrary to what the Supreme Court said and did in the *Robinson* case, *supra*. In remanding a cause to this Court so that a petition for rehearing might be filed and entertained, the Supreme Court necessarily construed the statutes as giving a litigant "authority in law" to file a petition for rehearing.

The statute (Title 28 U.S.C. Sec. 46(c)) provides for a rehearing en banc. Surely there must be a procedure whereby a litigant may request a court to take the action the law authorizes the court to take. Otherwise, two judges may prevent the other five from even being cognizant of the request for relief which the statute empowers the five to grant. And where two district judges are on the panel, two district judges could thereby prevent 7 circuit judges from granting a rehearing en banc, although only the circuit judges are qualified to pass on the question under Title 28 U.S.C., Section 46(c). *Commercial National Bank in Shreveport v. Connolly*, 177 F.2d 514 (1949), and *United States v. Sentinel Fire Ins. Co.*, 178 F.2d 217, 239 (1949).¹

If it is error for 2 judges to deny a petition addressed to 7, it must be error for 2 to interpose an iron curtain between the litigant and the remainder of the court by striking out the petition.

As for lack of authority "in the rules of the court" for petitions for rehearings en banc, we submit that it is incumbent upon the court to provide a procedure whereby the authority granted by Title 28 U.S.C. Sec. 46(c) may be invoked. In the absence of an express provision in the rules, it would seem clear that a motion

¹In each of these cases there was a disagreement whether a retired circuit judge was entitled to vote. There was no disagreement to the proposition that a petition for rehearing en banc could be acted on only by circuit judges.

or a petition addressed to the court is a proper and appropriate procedure to set the machinery in motion. It is significant that there is no provision in the rules that such a motion or petition will not be received or entertained, or delegating authority to a panel to deny it or strike it out.

An application to a court for an order is by motion. *R.C.P.* Sec. 7(b) (1). It must follow that where a court is empowered to make an order, the litigant must have the right to apply for it, i.e., the right to file a motion or petition. The doors of courts must always be open to litigants to apply for orders which the court is competent to grant.

LEGISLATIVE HISTORY OF TITLE 28 U.S.C., SEC. 46(c)

Title 28 U.S.C. Sec. 46(c) was occasioned by a conflict between this circuit and the third. In *Lang's Estate v. Commissioner*, 97 F.2d 867 (1938), this Court held that there was no basis in law for hearings or rehearings en banc. The third circuit held to the contrary in *Commissioner v. Textile Mills Corporation*, 117 F. 2d 62 (1940). On certiorari in the *Textile Mills* case, the Supreme Court upheld the third circuit.

It was then felt that the procedure approved by the Supreme Court should find more explicit expression in the statute, and S. 1053 was introduced in the 77th Congress to amend Section 212 of old Title 28 U.S.C. This bill was not then enacted, but it was adopted in substance when the Judicial Code was revised in 1948, becoming Section 46(c).

On August 16, 1948 Mr. Henry P. Chandler, Director of the Administrative Office of the United States Courts, transmitted to the Courts of Appeal the Final Report of the Committee on Codification and Revision of the Judicial Code (Judge Maris, Third Circuit, Chairman). This report states the contents of Section 46(c) and adds:

"These new provisions will call for changes in the rules of each of the Circuit Courts of Appeal."

It appears, however, that the rules of this Court were not changed as a consequence of the new Judicial Code, except as to the name of the court and the title of the Chief Judge.

In the hearings before the Subcommittee on Judiciary on S. 1053, 77th Congress, 1st Session, the following occurred:

"Senator Danaher: * * * On whose motion would the court assemble en banc?

* * * * *

"Senator Danaher: Who is going to make a motion that the whole court sit on this case? The counsel in the case?

* * * * *

"Mr. Chandler: The counsel can make a suggestion of course." (p. 16)

Again:

"Senator Danaher: Judge Groner, do you gentlemen of the bench have any thought to give us as to how we are going to let a majority of the circuit judges decide * * * when they are going to convene the court en banc?

"Judge Groner: Well, I never thought of that. My own thought in the administration of my own court would be that it would not be done unless counsel requested it, or unless the court of its own motion * * * deemed it advisable * * *" (p. 40)

HEARING EN BANC PARTICULARLY APPROPRIATE IN THIS CASE

The present case involves unique and important questions of bankruptcy and taxes. The decision conflicts with the decisions of two other circuits, the Second and the Fifth, *George A. Fuller Co. v. Commissioner*, 92 F.2d 72, and the *Shreveport Bank* cases, *Commercial National Bank in Shreveport v. Parson*, 144 F.2d 231; *Commercial National Bank in Shreveport v. Connolly*, 176 F.2d 1004; *Connolly v. Commercial National Bank in Shreveport*, 189 F.2d 608.

The case was decided by a panel consisting of two district judges and one circuit judge, and the opinion of the court was written by a district judge. As Judge Fee points out in his opinion of February 18th, three district judges have written opinions

in the cause. Both of those sitting in the Court of Appeals concurred that the opinion written by the district judge below was wholly erroneous. Yet the two district judges writing opinions in the Court of Appeals have completely differed from each other as well as from the district judge below. And no circuit judge has written a line on the merits. Finally, one of the participating judges has suggested a rehearing en banc.

CONCLUSION

We respectfully pray for leave to file the attached motion to vacate the order striking the petition for rehearing en banc, and submit that the motion should be granted and the petition for rehearing en banc should be reinstated and submitted to the court for its action under Title 28 U.S.C., Sec. 46(c).

Respectfully submitted,

HERMAN PHLEGER

MOSES LASKY

BROBECK, PHLEGER & HARRISON

FRANK C. NICODEMUS, JR.

NORRIS DARRELL

MAHLON DICKERSON

LEROY R. GOODRICH

*Attorneys for Appellant The
Western Pacific Railroad Cor-
poration.*

HERMAN PHLEGER

MOSES LASKY

BROBECK, PHLEGER & HARRISON

*Attorneys for Appellant Alexis
I. duP. Bayard, Receiver.*

San Francisco

March 7, 1952.

(Appendices follow)

Appendix I

[Caption omitted]

On Appellants' Petitions for Rehearing

Before: HEALY, Circuit Judge

FEE and BYRNE, District Judges

PER CURIAM

The petitions of the appellants and intervenors for a rehearing are denied. Insofar as the petitions seek a rehearing en banc, they are stricken as being without authority in law or in the rules or practice of the court. See *Kronberg v. Hale*, 9 Cir., 181 F.2d 767.

Appendix II

[Caption omitted]

On Appellants' Petition for Rehearing

Before HEALY, Circuit Judge, and FEE and BYRNE, District Judges

JAMES ALGER FEE, District Judge (dissenting and suggesting a rehearing en banc of all Circuit Judges):

This cause involves the disposition of over \$21,000,000.00. The solution requires application of novel statutory language affecting the fields of bankruptcy and taxes. I have expressed myself heretofore and still feel that the findings of the lower court do not support the determination made by two judges on the panel here.

I am unable to agree with either the denial of rehearing or the striking of the petitions which ask for a rehearing by the full complement of Circuit Judges of this Court en banc. Two District Judges and one Circuit Judge constituted the panel which heard the case. As has been pointed out in this serious and important litigation, three District Judges have, respectively, ex-

pressed three widely divergent views, while no member of the Court of Appeals has written a line on the merits.

I therefore suggest to the Court of Appeals a rehearing en banc of all the Circuit Judges. For this there is precedent in this Circuit.¹ The practice, as I understand it, substantially accords with that of the Third Circuit,² which is admirable. Inasmuch as this might be the court of last resort in this case, it seems fairer to have the issues disposed of by Circuit Judges.

The Supreme Court of the United States at least once has given permission to an appellant to apply to this court for a hearing en banc, 316 U.S. 649.³ In taking that action, reference was made to *Textile Mills Securities Corporation vs. Commissioner of Internal Revenue*, 314 U.S. 326.

(Endorsed:) Filed Feb. 18, 1952. Paul P. O'Brien, Clerk.

¹Judges Denman, Mathews and Stephens sat in *Hopper vs. United States*, 9 Cir., 142 F.2d 167, and Judges Wilbur, Denman and Healy sat in *Crutchfield vs. United States*, 9 Cir., 142 F.2d 170. At page 177 of 142 F.2d appears Circuit Judge William Deman's motion for a rehearing en banc of the *Hopper* case, *supra*, wherein it is stated that the cause is "now pending for rehearing in this Court." Accordingly, the rehearing of that case was held en banc before Judges Wilbur, Garrecht, Denman, Mathews, Stephens and Healy, being all of the Circuit Judges of this Court. *Hopper vs. United States*, 9 Cir., 142 F.2d 181.

²*United States vs. Gallagher*, 3 Cir., 183 F.2d 342, was heard by a panel of two Circuit Judges and one District Judge, and, upon suggestion of one of the Judges, was heard en banc by all Circuit Judges.

³See *Robinson vs. Johnston*, 9 Cir., 130 F.2d 202.

Appendix III

No. 12,506

IN THE
UNITED STATES COURT OF APPEALS
For the Ninth Circuit

WESTERN PACIFIC RAILROAD CORPORATION and
ALEXIS I. DUP. BAYARD, RECEIVER,

Appellants,

vs.

WESTERN PACIFIC RAILROAD COMPANY, SACRA-
MENTO NORTHERN RAILWAY, TIDEWATER SOUTH-
ERN RAILWAY, DEEP CREEK RAILROAD COM-
PANY, THE WESTERN REALTY COMPANY, THE
STANDARD REALTY AND DEVELOPMENT COM-
PANY and DELTA FINANCE CO., LTD.,

Appellees.

MOTION TO VACATE ORDER STRIKING PETITION FOR REHEAR-
ING EN BANC AND REINSTATING SAID PETITION, AND
PETITION FOR REHEARING EN BANC.

Appellants THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. DUP. BAYARD, RECEIVER, hereby move the court for an order vacating the per curiam order of January 30, 1951 striking these appellants' petition for rehearing en banc and reinstating said petition for action thereon by the Court.

The motion is based on the records of this Court and is made on the ground that rehearings en banc are authorized by Title 28 U.S.C., Sec. 46(c), that a petition for a rehearing en banc is an appropriate procedure under said section, and that appellants are entitled to the action on said petition of the Circuit Judges of the Ninth Circuit who are in active service.

And appellants THE WESTERN PACIFIC RAILROAD CORPORATION and ALEXIS I. DUP. BAYARD, RECEIVER, hereby petition the court for a rehearing en banc of the decision of October 29, 1951.

Dated: March 7, 1952.

HERMAN PHLEGER

MOSES LASKY

BROBECK, PHLEGER & HARRISON

FRANK C. NICODEMUS, JR.

NORRIS DARRELL

MAHLON DICKERSON

LEROY R. GOODRICH

*Attorneys for Appellant The
Western Pacific Railroad Cor-
poration.*

HERMAN PHLEGER

MOSES LASKY

BROBECK, PHLEGER & HARRISON

*Attorneys for Appellant Alexis
I. duP. Bayard, Receiver.*

